

International Corporate Rescue



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Secured Rights and Receiverships: Windfalls and Pitfalls

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Introduction

Despite the advantages of having security over a company's assets, there are issues which a secured creditor should take note of, from the point of negotiating the terms of the security instrument through to the point of enforcement. Receiverships are a key method of enforcement and enable secured creditors to realise the secured property and recover the secured debt. This article provides a practical consideration of those matters from an enforcement perspective and discusses the points that a secured lender should be aware of in order to maximise its chances of recovering its debt in full.

The terms of the security instrument

Receivership is a contractual self-help remedy available to secured creditors on the terms set out in the security instrument. The terms of the security instrument will inevitably have an impact on the efficiency (in both practical and cost terms) with which the secured creditor is able to enforce its security and take control of the secured property. If the secured creditor wants to enforce its security by appointing a receiver, the secured creditor will not only want to ensure that the security instrument gives the secured creditor the ability to appoint a receiver but it will also want to make sure that the receiver, once appointed, will have all the powers he or she needs to realise the value of the secured property.

It is not just the terms of the security instrument itself that need careful consideration, the ancillary documents that accompany the security document will also have an impact on how cost-effectively and how quickly, the security can be enforced. The ancillary documents are typically used to transfer power to the secured creditor or to a receiver appointed by the secured creditor to enable the secured creditor to take control of the secured property. Where the secured property is charged shares in a BVI or Cayman Islands company (the 'Target Company'), the ancillary

documents are used to vote the charged shares in order to take control of the Target company at board level.

Where the security is in respect of shares in a BVI or Cayman company the typical ancillary documents one would expect to see would include the following:

- (a) A share transfer form in respect of the charged shares;
- (b) A letter of instruction from the chargor to the registered agent of the Target Company instructing the registered agent to accept the secured creditor as its new instructing party;
- (c) Signed but undated resignation letters from each of the directors of the Target Company;
- (d) A letter of authority from each of the resigning directors, authorising the secured creditor to date and submit the resignation letters to the registered agent of the Target Company; and
- (e) An irrevocable proxy and/or power of attorney executed by the chargor, appointing the secured creditor as its proxy to vote the chargor's shares in the Target Company and/or act as its attorney to sign written resolutions of the Target Company on behalf of and in respect of the charged shares.

Registering charges in BVI and Cayman

BVI

After the terms of a charge have been agreed and signed by the parties, it is important promptly to register the charge as this will determine its priority. In the BVI, section 166 of the BVI Business Companies Act 2004 (the 'BCA') provides that a registered charge will have priority over a charge that is subsequently registered or that is not registered.¹

A BVI company will have two registers of charges: a register of charges that is for internal purposes and a register of registered charges that is a publicly available document held by the BVI Registry of Corporate Affairs.

Notes

¹ This order of priorities can be varied with the express consent of the holder of the charge that has the priority, or by agreement between the charges: see section 167 of the BVI Business Companies Act 2004.

Cayman

There is no general central public registry or statutory priority regime in relation to charges created by Cayman Islands' companies. However, under the Cayman Islands Companies Law (2018 Revision) (the 'Companies Law') each company must maintain a register of mortgages and charges at its registered office in the Cayman Islands. Failure to update the register leaves the company and directors liable to a financial penalty but does not invalidate the security itself. Hence, following execution of the security documents, the secured party should ensure that particulars of their security are entered on the register of mortgages and charges of the company granting the security. The secured party will also typically request that the security provider delivers to them a certified copy of the updated register of mortgages and charges on or shortly after the date on which the security documents are entered into. Secured parties should ensure that the security instrument obliges the company granting the security to deliver a certified copy of the updated register of mortgages and charges to its registered office promptly following execution of the security instrument.

The register of mortgages and charges is not a publicly searchable register, although under the Companies Law it is open to inspection by creditors and members at all reasonable times. While no statutory priority is afforded to the security holder by ensuring its security is registered, it does put third parties that are provided with a copy of the register of mortgages and charges on actual notice of the existence of the security. As priority of competing security interests would be determined on the basis of common law principles, it is prudent for creditors taking floating charges to require that brief particulars of any negative pledge given by the exempted company in respect of the secured assets are included in the register of mortgages and charges. Although there is no statutory time limit for completing the registration, it is prudent for secured creditors to ensure security is registered as soon as possible given these potential priority implications.

In addition, where a shareholder of a Cayman Islands exempted company grants security over the shares it holds in that exempted company, it is market practice to include in the security document a requirement that a notation is made on the register of members of the exempted company to the effect that the shares are secured in favour of the relevant creditor. It is not possible to file the annotated register of members on a publicly searchable register in the Cayman Islands. Secured

creditors will allow a short period following execution of the relevant share security instrument for the notation on the register of members to be completed and a certified copy of the updated register to be provided to the secured creditor. As with updates to registers of mortgages and charges, it is possible to have the register of members updated quickly (including on the date of execution of the security document), if the registered office of the exempted company is given the required notation wording in advance and time zones permit.

After registration

Key amongst the benefits that accrue to the security holder is the protection of that security if the company goes into liquidation. The Companies Law provides that, regardless of any winding up order made in respect of the company, any creditor who has security over the whole or part of the assets of the company is entitled to enforce its security without the leave of the Court and without reference to the liquidator.²

Similarly, in the BVI, the Insolvency Act 2003 (the 'IA') confirms that the commencement of the insolvent liquidation of a BVI company does not affect the right of a secured creditor³ to take possession of and realise or otherwise deal with the assets of the company over which it has a security interest⁴ (which protection also exists in respect of a solvent liquidation⁵).

Chargee in possession or receiver?

Following an event of default under the security instrument, the secured creditor will need to decide whether or not it is going to take control of the charged shares that are the subject of the security. If it makes the decision to take control of them it will need to decide whether it is going to take control of them in its own right or by appointing a receiver of them. If the secured creditor decides to appoint a receiver, it will usually want to appoint a professional receiver. Appointing a professional receiver of the charged shares has the following advantages and it is the usual step a secured creditor takes:

1. Where the company is a private company and there is no readily available market for selling the charged shares, a professional receiver will have the necessary experience to market those shares with a view to obtaining the best price reasonably obtainable for them;

Notes

² Section 142 of the Companies Law (2018 Revision).

³ Section 9 of the Insolvency Act 2003 (the 'IA') defines a creditor as a 'secured creditor' of a debtor if it has an enforceable security interest over an asset of the debtor in respect of their claim.

⁴ Section 175 of the IA.

⁵ Section 197 of the BCA provides that although a company may be voluntarily liquidated despite the existence of a charge registered in respect of its property, the liquidator is bound to give effect to the rights and priority of the claims of the company's secured creditors.

2. If the secured creditor wants to buy the charged shares, it is possible to purchase them from the receiver (it is not possible for the secured creditor to sell the charged shares to itself);
3. The registered agent of the Target Company is more likely to cooperate with a third party professional receiver (that it often knows and trusts) than with a secured creditor directly because it will perceive the professional receiver as being neutral;
4. If the secured creditor takes possession of the charged shares, it is under a duty to the chargor, the company, any sureties and any subsequent holders of security, to safeguard the value of the shares. The secured creditor is also under a duty to account for profits received whilst it is in possession of the charged shares, as well as for profits which would have been received but for any failure by them to exercise due diligence. By appointing a receiver the secured creditor passes these various obligations and duties to the receiver and, in that way, insulates itself from any potential liabilities;
5. Unlike a mortgagee in possession, a receiver acts as agent for the chargor, so it can take enforcement action without first having to secure a change in legal title to the charged shares;
6. Although the receiver is the agent of the chargor, he must exercise his powers in good faith, for a proper purpose and in a manner in which he reasonably believes to be in the best interests the party appointing him, meaning that the receiver looks after the interests of the secured creditor; and
7. Where the charged shares are in the hands of a receiver, they are kept off the secured creditor's balance sheet.

The rights, powers and duties of the receiver

A receiver is typically appointed out of court by the secured creditor in accordance with the terms of the security instrument following a contractual event of default, although they can also be appointed by the Court.

Cayman

In the Cayman Islands, there is no statutory guidance on the rights, powers and duties of a receiver so the secured creditor must look to the terms of the security

instrument and the common law. The powers of the receiver to deal with the secured property should be fully set out in the security instrument and they may only be exercised for the purposes for which they are conferred. Typical powers granted to receivers would include the power to take possession of, sell and/or manage the secured property, the power to exercise all voting rights relating to the secured property, and the power to receive and retain all dividends or interest accruing in respect of the secured property.

The receiver owes his or her primary duties to the secured creditor, with secondary duties owed to the security provider and any other party with an interest in the equity of redemption of the secured property. The receiver must exercise his or her duties in good faith.

The receiver is not obliged to exercise any power of sale or to realise the secured property within a specific period of time following his or her appointment but if and when he or she does decide to exercise a power of sale, they must take steps to obtain the best price reasonably obtainable for the secured property at the time of sale. If, having regard to his or her duties, the receiver decides not to sell the secured property immediately following their appointment, they have a duty to act diligently when exercising the rights in respect of the secured property.

BVI

The IA provides that a receiver has the powers expressly or impliedly conferred on them by the charge or other security instrument pursuant to which they are appointed.⁶ The IA also provides that, unless the security instrument expressly provides otherwise, a receiver has the power to (a) demand and recover, by action or otherwise, income of the assets in respect of which he or she is appointed; (b) issue receipts for income recovered; (c) manage, insure, repair and maintain the assets in respect of which they are appointed; and (d) exercise, on behalf of the company, a right to inspect books or documents that relate to the assets in respect of which they were appointed in the possession or under the control of a person other than the company.⁷

Consistent with the common law position, the IA also provides that the primary duty of a receiver is to exercise his or her powers in good faith, for a proper purpose and in a manner they reasonably believe to be in the best interests of the person in whose interest they are appointed.⁸ Also, when exercising a power of sale of the secured assets, the IA provides that the receivers owe a duty to the creditors, any sureties, the company

Notes

6. Where a receiver is appointed by the Court, he or she will have the powers granted to them in the Court's order appointing them: section 127(1) of the IA.
7. Section 127(2) of the IA.
8. Section 128 of the IA.

and to any persons claiming an interest in those assets through the company to obtain the best price reasonably obtainable at the time of sale.⁹

Appointing a receiver

Cayman

There are no statutory provisions under Cayman Islands law providing for how a receiver should be appointed and there is no statutory requirement to register the appointment of a receiver. The appointment must simply be made in accordance with the terms of the security instrument, in order to be valid.

BVI

The IA provides a statutory procedure for the appointment of a receiver out of Court as follows:

1. The appointment must be made in writing, typically by a deed of appointment, executed by the secured creditor in favour of the receiver, setting out the terms on which the receiver is appointed;¹⁰
2. The appointment of a receiver is not effective unless the receiver accepts his or her written notice of appointment before the end of the next business day following the day on which they receive the notice of appointment;¹¹
3. The acceptance of the appointment can be given orally or in writing but if it is given orally, the receiver must confirm their acceptance in writing to the person appointing them, within seven days;¹²
4. A confirmation or written acceptance of appointment must state (a) the time and date of receipt of the notice of appointment; and (b) the time and date of the acceptance of the appointment;¹³
5. A deed of indemnity, indemnifying the receivers for any loss, damage or costs that may be incurred by them during the course of their appointment, is also typically entered into by and between the secured creditor and the receiver; and
6. Forthwith upon his or her appointment, the receiver must send a notice of appointment to the company and file a notice of appointment with the Registrar of Companies and, if the company is or

has been a regulated person, with the Financial Services Commission and a receiver who fails to do any of these things commits an offence;¹⁴

A potential obstacle that can arise when appointing a receiver to take control of charged shares is when the registered agent of the Target Company refuses to recognise the secured creditor's authority to act in relation to the charged shares. This issue typically arises where the registered agent's client of record tells the registered agent that there has not been an event of default under the security instrument and that the secured creditor is therefore not in a position, contractually, to enforce its security interest. In the face of conflicting instructions from the registered agent's client of record and the secured creditor there is a risk that the registered agent will refuse to act on the instructions of either party and insist on seeing a Court order before acting. In these circumstances, the secured creditor may need to consider changing the registered agent of the Target Company or making an application to the Court to rectify the Target Company's share register to record it as the legal owner of the Target Company's shares, and incur the delay and costs associated with that.

However, in January 2016, s.91B of the BCA was brought into force to remedy this as follows (emphasis added):

'Subject to the memorandum and articles of a company, a registered agent shall (a) act on the instructions of the directors of the company if those instructions are contained in a resolution passed by the directors and a copy of the resolution is made available to the registered agent; and (b) recognise and accept the appointment or removal of a director or directors by members of the company.'

Section 91B(b) is a welcome and significant development, particularly for those secured creditors where time is of the essence because they are under pressure to recover the debt or because there is a concern that whilst the Target Company remains in the hands of the chargor there is a risk that its assets will dissipate or disappear. It is common in such cases for the secured creditor to appoint the receivers as directors of the Target Company, whether alongside or in replacement of the incumbent board, so that they, through the receivers, have direct access to the Target Company's assets and can exert control over the whole of the Target Company even where, for example, the charge is only

Notes

9 Section 129 of the IA.

10 The appointment of the receiver takes effect from the time the receiver receives the written notice of appointment: Section 139(1) and (2) of the IA.

11 Section 139(4) of the IA.

12 Section 139(5) of the IA.

13 Section 139(8) of the IA.

14 Section 118 of the IA.

over 50% of its shares. Once the secured creditor has direct or indirect (through a receiver) control of the board of the Target Company, the registered agent must (under section 91B(a)) act on the board's instructions to realise the Target Company's assets with a view to satisfying the debt owed to the secured creditor. Clearly, the initial cooperation of the registered agent in accepting the appointment of the receivers as directors of the Target Company (and accepting the removal of the incumbent directors) is key.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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