Privy Council rules on Bermuda's 60/40 rule. What are the implications for the Cayman Islands?

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Each of the Cayman Islands and Bermuda has legislation and regulation designed to promote and preserve local control over the jurisdiction's economic life. This is unsurprising given in each case the high proportion of expatriates to persons with Caymanian or Bermudian status, as the case may be.

To achieve this goal, each jurisdiction has a 60/40 rule that regulates when a company can carry on a local business.

Cayman's 60/40 rule

The key provisions of Cayman's 60/40 rule are sections 4(1)(a) and 5(1) of the Local Companies (Control) Law (2019 Revision) (the **LCC Law**).

Under section 4(1)(a), "*[s]ubject to subsection (3), no company shall carry on business in the Islands unless it is so empowered by its Memorandum of Association and —*

a. *it is —*

b. *a local company; or*

c. *an exempted company carrying on business in the Islands,*

which, at the relevant time, is complying with section 5 or is a wholly owned subsidiary of such a company".

Section 5(1) is the key provision for present purposes. It provides that, for the purpose of section 4(1)(a), "*a local company or an exempted company that is carrying on business in the Islands is complying with this section if —*

a. *it is Caymanian controlled*

b. *at least sixty per cent of its shares are beneficially owned by Caymanians; and*

c. *at least sixty per cent of its directors are Caymanians.*"

(The underlining has been added.)

Put simply, with certain exceptions, a local company or a qualifying exempted company may only carry on business in the Cayman Islands if it is Caymanian controlled, at least 60% of its shares are beneficially owned by Caymanians, and at least 60% of its directors are Caymanians. The most significant exception (see section 4(1)(b) of the LCC Law) is where a company is licensed by the Trade and Business Licensing Board (the **T & B Licensing Board**) to carry on business in the Islands under the LCC Law and under the Trade and Business Licensing Law (2019 Revision) (the **T & B Licensing Law**), having regard to the factors in section 11(4) of the LCC Law. (One of those factors is the desirability of retaining in the control of Caymanians the economic resources of the Islands.)

Bermuda's 60/40 rule

Bermuda's 60/40 rule in primarily found in section 114(1)(a) of its Companies Act 1981 (the **1981 Act**) and in Part 1 of the Third Schedule to that Act. The 1981 Act draws a distinction between local companies incorporated in Bermuda and controlled by Bermudians, which may carry on business in Bermuda, and other companies, which, unless exempted, must be licensed by the Minister of Finance to carry on such business.

Section 114 of the 1981 Act sets out the circumstances in which a local company may carry on business in Bermuda and, so far as relevant, provides:

"*(1) No local company shall carry on business of any sort in Bermuda unless -*

a. *it is a company which, at the relevant time, complies with Part I of the Third Schedule or is a wholly-owned subsidiary of such a company; ...*"

And, relevantly, Part 1 of the Third Schedule provides:

"*THIRD SCHEDULE*

(Section 114)

PART I

PROVISIONS TO BE COMPLIED WITH BY A LOCAL COMPANY CARRYING ON BUSINESS IN BERMUDA

1(1) The company shall be controlled by Bermudians.

(2) Without prejudice to the generality of sub-paragraph (1), at least 60 per centum of the total voting rights in the company shall be exercisable by Bermudians.

2(1) The percentage of Bermudian directors, and the percentage of shares beneficially owned by Bermudians, in the company shall not be less than 60 per centum in each case:

Provided that the company shall not be deemed to be in breach of this paragraph in so far as, and so long as, it is acting in accordance with sub-paragraph (2) ..."

(The underlining has been added.)

What did the Privy Council decide?

Bermuda's 60/40 rule came under scrutiny by the Privy Council in *Bermuda Bar Council* v *Walkers (Bermuda) Ltd* (Bermuda) [2019] UKPC 25 (10 June 2019) in which the main question was the nature of foreign control over a local company which would prevent it from being "*controlled by Bermudians*" and thus require it to be licensed by the Minister of Finance.

Facts

The case arose out of an arrangement between Walkers (Bermuda) Ltd (**WBL**) and a Bermudan barrister, Kevin Taylor.

- In May 2015, Walkers Global, a partnership established under the laws of and based in the Cayman Islands which has developed an international offshore law business in several jurisdictions, announced that it would expand its business by opening an office in Bermuda and that it would be "the first major international offshore firm to enter the Bermuda market".

- In October 2015, WBL was incorporated as a local company under the 1981 Act. WBL was incorporated with view to providing legal services under the "Walkers" brand name. Mr Taylor legally and beneficially owned, and owns, 99% of the shares in WBL and 1% was owned by another Bermudian barrister. Mr Taylor was, and is, the sole director of WBL.

- Draft agreements were prepared between WBL and Walkers Global, namely, a Licensing and Services Agreement (**LSA**) and a Loan Agreement (**LA**) (together, the **Agreements**). The LSA would, if executed: govern the relationship between WBL and Walkers Global; permit WBL to provide legal services under the Walkers brand; require WBL to pay a licence fee to Walkers Global; and enable WBL to draw on extensive services provided by Walkers Global. The LA would, if executed, provide for Walkers Global to lend up to US$5m to WBL. In the words of

Kawaley CJ at first instance, the proposed arrangements "*clearly propose[d] to confer on Walkers Global a considerable amount of commercial influence over [WBL]*".

- Mr Taylor applied to the Bermuda Bar Council for a certificate of recognition of WBL as a professional company under s 16C of the Bermuda Bar 1974. The Bar Council refused to grant a certificate of recognition on the basis that the proposed commercial arrangements with the Walkers Global would result in effective control over the applicant passing to the Walkers Global contrary to section 114 of, and Part 1 of the Third Schedule to, the 1981 Act 1981, which, read together, required a Bermudan company to "*be controlled by Bermudans*.", In effect, the Council considered that Walkers Global would be in effective control as a result of its commercial influence over WBL through the Agreements.

On the applicant's originating motion challenging the refusal to issue a certificate, Kawaley CJ in the Supreme Court of Bermuda, having read the relevant provisions as prohibiting a local company from carrying on business in Bermuda unless it was in substance as well as in form at least 60% owned and controlled by Bermudans, held that since the applicant's shareholders had undoubted ownership and control of it, the proposed business model giving the Walkers Global effective control over commercial matters was not contrary to section 114 and Part 1 of the Third Schedule.

On the Council's appeal, the Court of Appeal for Bermuda, in purported reliance on previous authority of the Privy Council, interpreted the relevant provisions as extending beyond control over the voting power of shareholders and directors so as to include the substance and reality of commercial control, and on that basis restored the Council's decision.

Held

The Privy Council restored Kawaley CJ's decision. The principal judgement was given by Lord Hodge (with whom Lords Reed, Kerr and Briggs agreed); and Lady Arden gave a separate judgment in which she concurred in the result but for different reasons. The Board approved the reasoning of Kawaley CJ (save in one minor respect) that "*controlled by Bermudians*" in para 1(1) of the Third Schedule to 1981 Act refers to *corporate* rather than *commercial* control. In particular, it held that de facto control by commercial arrangements which might influence the policy of the decision-making organs of a relevant company but not impose a legal obligation on the decision-makers to vote in a particular manner is not the target of the 1981 Act.

Does Bermuda Bar Council v Walkers (Bermuda) Ltd apply to Cayman's 60/40 rule?

Would the "*Caymanian controlled*" requirement be interpreted in the same way as the "*controlled by Bermudians*" requirement? Or, could *Bermuda Bar Council* v *Walkers (Bermuda) Ltd* be distinguished because (for instance) section 3(2) of the LCC Law provides that "*[f]or the purposes of [the LCC Law], a company shall be deemed to be Caymanian controlled if the [T&B*

Licensing Board] is satisfied that effective control is not, either directly or indirectly, or by reason of any arrangement, artifice or device vested in, or permitted to pass to, persons who are not Caymanians". (The underlining has been added.)

Lady Arden explained, citing the Privy Council's earlier decision in *Bermuda Cablevision Ltd* v *Colica Trust Co Ltd* [1998] AC 198 (*Bermuda Cablevision*), that the meaning of "control" is contextual, and that it is not a term of art with a fixed meaning. Despite this, it is submitted that the "*Caymanian controlled*" requirement under Cayman's 60/40 rule and "*controlled by Bermudians*" requirement under Bermuda's 60/40 rule are so contextually similar as the make *Bermuda Bar Council* v *Walkers (Bermuda) Ltd* indistinguishable for Cayman purposes. Without seeking to be exhaustive, this article notes the following points of similarity.

1. Lord Hodge relied on two primary grounds, being grounds equally applicable to Cayman's 60/40 rule, for concluding that control means *corporate*, not *commercial*, control.

    a. First, he noted that, under section 114(1)(a) of Bermuda's 1981 Act, a local company can carry on business in Bermuda not only if it complies with Part I of that Schedule but also if it is the wholly-owned subsidiary of a company which so complies. He further noted that the relevant definition of subsidiary looks to the ownership of the shares of the company and the power of the votes attached to such shares to elect the directors of the company. Such analysis applies with equal force to the "*wholly owned subsidiary of such a company*" option under section 5(1) of Cayman's LCC Law.

    b. Secondly, his Lordship offered this further "equally powerful consideration" which also applies to Cayman:

    "If it were sufficient to establish non-Bermudian control by commercial control alone, a local company might face intolerable uncertainty as to whether it was carrying on business legally or was committing an offence. For example, if a primary producer in Bermuda were to enter into an exclusive supply agreement with an overseas buyer which made it dependent on the commercial decisions of the buyer, the latter would have considerable influence over the supplier's commercial decisions and in one sense have the potential to control the quantity and quality of the supplier's products. If such control by itself sufficed, the legality of the supplier's business would depend on the way in which the overseas buyer chose to exercise its commercial influence. Similarly, a local company, which had borrowed large sums from an overseas lender, might get into financial difficulty such that it had to act in accordance with the wishes of its lender. There would be great uncertainty as to what actions of, or advice by, the lender would amount to control thereby causing the local company to commit an offence. In each case the local company would not have any escape route such as paragraph 2(2) of Part I of the Third Schedule provides (para 11 above). The Board is persuaded that the legislature did not

intend the concept of control of a local company in the 1981 Act to extend so far."

2. Next, Bermuda's 1981 Act also includes phrases such as "*effective control*" and "*arrangement, artifice or device*". As to the phrase "*effective control*", Lord Hodge concluded that it was not "clear whether the phrase is intended to have a different meaning from the word "controlled" in paragraph 1(1) of Part I of the Third Schedule". And, as for expression "*arrangement, artifice or device*", his Lordship said that it was a composite phrase that appeared to address structures or arrangements designed to negate or render illusory the legal control which flows from 100% or majority share ownership rather than ordinary commercial arrangements.

In short, what the Privy Council held as to the meaning of "*controlled by Bermudians*" for the purpose of Bermuda's 60/40 rule applies with equal force to interpretation of "*Caymanian controlled*" under Cayman's 60/40 rule.

What are the practical implications of Bermuda Bar Council v Walkers (Bermuda) Ltd for the application of Cayman's 60/40 rule?

First, it is clear that the "*Caymanian controlled*" requirement is directed to control of a company's decision-making organs, whether in general meetings or board meetings; it does not extend to control over day-to-day matters. As Lord Hodge said, "[t]he Board interprets paragraph 1(1) of Part I of the Third Schedule as preventing agreements or arrangements which confer voting control or constrain the effectiveness of majority votes in the board of directors or in general meetings". The reason why Lady Arden concurred with the decision of the other members of the Privy Council is that, in her view, the Court of Appeal for Bermuda had failed to have regard to the statutory context when it concluded that control was general and without restriction, because it had failed to analyse control in terms of the effect on WBL's corporate decision-making process.

Secondly, commercial influence is not irrelevant, but only when it is taken into account in combination with corporate control. For instance, Lord Hodge said of the Privy Council's earlier decision in *Bermuda Cablevision* that it is not authority for the proposition that commercial influence by a non-Bermudian entity over the decision-making of a local company is sufficient by itself to prevent that company from carrying on business of any sort in Bermuda without a licence from the Minister. According to his Lordship, it was the combination of contractual and constitutional controls that led to a finding in that case of control in the requisite sense.

Thirdly, the 60/40 rule does not mean that a minimum percentage of profits must be attributed to Caymanians or Bermudians, as the case may be. Whilst the Board generally endorsed Kawaley CJ's judgment, it did not endorse that part of the Chief Justice's judgment where he said that the requirement that the company be controlled by Bermudians "speaks to the ability to … receive the sort of economic benefits equivalent to holding more than 40% of a local company's shares". Lord Hodge, in giving the opinion of the Board, noted that "t]here is no

requirement in the 1981 Act, either expressly stated or arising by necessary implication, that a local company must pay or attribute a minimum percentage of its profits to Bermudians in order for it to be controlled by Bermudians." Lady Arden, however, who was in the minority on this point, agreed with Kawaley CJ. Her Ladyship took the view that, once it is established that putative control is sought to be exerted at the *level* of the decision-making process, it is appropriate to take a wide view of the *means* of such control to determine if it offends the "*controlled by Bermudians*" requirement.

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