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Bermuda – Developing as an E-Commerce Hub For International Trade

Introduction

Just as The Insurance Act 1978 of Bermuda laid the groundwork to Bermuda becoming a leader in the captive insurance and reinsurance fields, Bermuda has now cast its net in the area of e-commerce. It is one of the few respected low taxation jurisdictions offering sophisticated telecommunications' capability along with the necessary expertise and infrastructure to develop into a substantial B2B e-Commerce hub for cross border transactions or international trade because it adds significant legal, business and regulatory value to such transactions.

The International Dilemma

The utilization of the Internet for international trade has dramatically challenged and changed the traditional models of doing business and the legal paradigms that apply. One of the great strengths of the Internet is its wide-open borders with few standards or regulations but when it comes to e-commerce, that strength could also be a weakness because there is less than perfect certainty in many countries as to whether a contract executed on-line will be honored in the real world.

What happens in a transaction between two parties when one country recognizes an electronic contract or digital signature but the country of the other contracting party does not? What happens when the law of one country is very different from the law of another country on a significant issue? The lack of clarity

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**Reasons For Incorporating
In Bermuda**

- Respected International Business jurisdiction (built on the principle of "know your customer");
- Tax Neutral Business

brought about by different approaches to these issues by governments has had a negative effect on the development of B2B e-commerce.

The Bermuda Solution

To address the above-mentioned issues, Bermuda has taken significant legislative steps to provide businesses engaged in electronic business with an e-friendly but predictable and secure legal environment from which to operate by building upon its strong English common law traditions and innovative legislative approaches as exemplified in the passing of the very comprehensive Electronic Transactions Act 1999 (the "Bermuda Act") that facilitates cross-border business conducted on-line with businesses that have some substantial connection to Bermuda (either through a Bermuda entity or through a foreign entity or a B2B Exchange that operates in or from Bermuda)

In addition, Bermuda's sophisticated international business environment can provide a host of value-added on-line services such as trade and export credit insurance, trade financing, escrow services, settlement and on-line dispute resolution. These are a few of the initiatives that are developing in Bermuda to pave the way for Bermuda to become a credible B2B e-commerce hub.

Legal Situs

Legal 'situs' or choice of law provisions in electronic contracts has continued to be a problem for cross-border e-commerce and in many cases the governing law of the contract may be a jurisdiction that does not grant legal certainty or validity to on-line contracts. When a cross-border electronic contract does not specify a particular jurisdiction as the governing law, there may be instances when an electronic contract could be considered invalid because neither the jurisdiction of the buyer or the seller has legislation authorizing an electronic offer and acceptance or electronic signature. In addition, some jurisdictions may not have Certification Authorities in place to verify or authenticate digital or electronic signatures or records.

Electronic contracts that are entered into by sellers or buyers operating from a Bermuda base or through a B2B Exchange in Bermuda such as the World E-Commerce Exchange ("WECX"),

Environment (no income, capital gains, transfer or withholding taxes);

◦ Business sensitive and well established Legal System (based upon English common law);

◦ Minimal Government Annual Reporting except for Restricted Businesses;

◦ Access to Capital Markets (through Bermuda Stock Exchange listings);

◦ Access to one of the most successful Insurance/Reinsurance Markets in the world;

◦ Reliable Banking System;

◦ Efficient Support Services (legal, accounting, management, corporate and trust services);

◦ State-of-the-Art Global Internet Services and Telecommunications (connecting Bermuda to the world); and

◦ Friendly yet efficient business environment for holding Company Meetings.

that have Bermuda law as the governing law of the contracts, can avail themselves of the laws of Bermuda and provide legal certainty and predictability to the cross-border transaction. For further information on WECX please see their website at www.wecx.com.

The Electronic Transactions Act 1999

The focus of this article is on the e-commerce legislative initiative in Bermuda that supports the development and growth of Bermuda as a global hub for international trade or commerce.

Many countries have been slow to pass appropriate legislation for e-commerce and some have done it piecemeal. Bermuda has emerged as one of the leaders in the global e-commerce marketplace by passing The Electronic Transactions Act 1999 (the "Bermuda Act"). The Bermuda Act also significantly conforms to the United Nations Commission on International Trade ("UNCITRAL") model law on e-commerce.

The Bermuda Act was not designed to regulate the Internet or to alter any existing legal rights or obligations. Rather, it sought to remove existing legal impediments to e-commerce by allowing parties to satisfy the requirements of the law while using electronic communication.

The legal ambiguities that existed around the world previously in the e-commerce arena, which many analysts viewed as barriers to the development of secure on-line cross-border business, have been addressed and dealt with by the passing of the Bermuda Act and it is expected that many of the large global corporations will look to Bermuda once again for clarity and predictability when conducting on-line cross border business.

The Bermuda Act accomplishes five objectives:

- It brings certainty to electronic contracts by expressly defining and authorizing the use of electronic records and electronic signatures, removing any doubt about their enforceability and admissibility under Bermuda law.
- It clarifies the legal rules relating to formation and validity of electronic contracts or transactions entered into electronically.

- It enhances the reliability and legal trust necessary to facilitate and promote ecommerce by creating a new category of 'accredited certificate' which is a digitally signed statement by a Certification Service Provider of a computer based record that provides independent confirmation of an attribute claimed by a person proffering a digital signature.
- It provides for the development of trusted third parties that can add to the legal trust and reliability of the Bermuda e-commerce environment by introducing the Certification Service Providers (also known as Certification Authorities) and intermediaries or e-commerce service providers; and providing for voluntary registration or accrediting systems for them with appropriate standards for their operation in Bermuda.
- It also links certain statutory limitations on liability of such Certification Service Providers, intermediaries and e-commerce service providers to the registration of such entities under the Bermuda Act.

The ultimate aim of any e-commerce law is to give legal recognition to electronic signatures and electronic records thereby ensuring that the use of an electronic signature on an electronic record will be treated in the same manner as a handwritten signature or written document.

The Bermuda Act provides that the use of information in an electronic form (whether an electronic signature, electronic document, statement, declaration of intention or electronic record) will not be invalid simply because it took place by means of an electronic communication. However, any electronic transaction must still satisfy other existing legal requirements of general application depending on the subject matter.

The Bermuda Act makes it abundantly clear when dealing with contracts that an offer and acceptance (unless otherwise agreed by the parties) may be expressed by means of an electronic record. The Bermuda Act also clarifies the admissibility of electronic records as evidence in legal proceedings provided regard shall be had to the reliability and integrity of, and manner in which, the record was generated, stored, maintained or communicated. The integrity of the record is ensured by the requirement that certain conditions be satisfied (namely, that information contained in the

electronic record be accessible and capable of retention for subsequent reference and represents accurately that information).

The Bermuda Act does not in any way reduce the need for the application of other existing laws and complex rules about consideration, breach, title, security interests, fraud or any of the myriad of other matters addressed by other commercial and criminal laws in Bermuda.

Statutory Exemptions

Many countries (particularly common law jurisdictions) require certain transactions to be in writing in order to be valid. In Bermuda, there will continue to be situations in which the use of written documents will be obligatory such as testamentary dispositions and conveyances of interest in real property, with the result that such transactions cannot be in electronic form.

Conclusion

The Bermuda Act sets the basic legislative framework for electronic commerce done through or in Bermuda by removing any legal impediments to the validity, admissibility and enforceability of electronic signatures and electronic records and establishing standards for the e-commerce professionals to operate within. By addressing many of the ambiguities relating to conducting business on-line, the Bermuda Act has gone a long way to reinforce business and consumer confidence in e-commerce in Bermuda and has facilitated the move on the part of Bermuda in becoming an international hub for cross border e-commerce.

US Courts Piercing the Corporate Veil of a Bermuda Exempted Company

A little over a year ago, in April 2003, the Supreme Court of the State of New York, Appellate Division, First Department, unanimously held the judgment of the Supreme Court for New York County entered a year earlier that the corporate veil of Ardra Insurance Company Ltd (“Ardra”) should be pierced and that compensation should be paid by shareholders of that company in the amount of some \$28,000,000.00. This was the last decision in

a series of decisions delivered over nearly a decade.

The decision of the New York Court to pierce the corporate veil of Ardra appears to be based on section 1505(a)(1) of the New York Insurance Law and it seems to be accepted in American legal circles that the decision in the case of Ardra is an exception to the general rule that shareholders will not be liable for the debts of the company in the absence of some wrongdoing.

By way of background, the facts as found in the various courts are that Ardra had entered into reinsurance treaties with a company called Nassau Insurance Company, ("Nassau"), a New York corporation, and both Ardra and Nassau were owned by Tiber Holding Corporation ("Tiber"), which in turn was owned and controlled by the Di Loreto family. The only reinsurance treaties entered into by Ardra were those with Nassau. Nassau was placed in liquidation in New York in 1984 and the State Superintendent of Insurance was appointed the liquidator of Nassau. The Order placing Nassau in liquidation contained a provision permanently restraining any person from bringing or furthering the prosecution of any actions at law against Nassau. In 1985 the liquidator of Nassau commenced proceedings in New York to recover sums of money said to be due under the treaties with Ardra. Ardra initially sought to compel arbitration under the treaties and to stay the New York action, but in 1988 those proceedings failed on the bases that New York law provided a statutory scheme for liquidating insurance companies and overrode the contractual provision of the relevant treaties. That decision was upheld by the New York Court of Appeal in 1990.

In the meantime, in 1987, Ardra commenced proceedings in Bermuda seeking a declaration of the validity of the arbitration clause for one of the treaties (which had provided for arbitration in Bermuda) and an injunction to restrain the liquidator of Nassau from pursuing any court proceedings in relation to disputes which are the subject matter of the arbitration clause. At the same time, Ardra applied for and was granted an interim injunction restraining the liquidator of Nassau, for a period of 28 days, from taking any further steps in the courts of the State of New York which would interfere with the proceedings in Bermuda or taking or continuing any judicial proceedings against Ardra in relation to the disputes which were the subject matter of the arbitration clause. The liquidator of Nassau did not appear in the Bermuda proceedings but instead commenced contempt proceedings against Ardra in New York and sought to have Ardra found in contempt for instituting the Bermuda action. The alleged

contempt was the breach of the prohibitions upon instituting or continuing proceedings against Nassau or its liquidator mentioned above. The application to find Ardra in contempt in New York was eventually denied on procedural grounds, and though it was renewed in 1988 there was never any conclusion to that application.

Substantive proceedings continued in New York and in 1991 the New York Supreme Court, on the application of the liquidator of Nassau, ordered that Ardra should post pre-answer security (for costs) of more than \$10,000,000.00 within thirty days. That Order was made in accordance with New York procedural law.

As Ardra was unable to post the required amount of pre-answer security within the time frame imposed, its answer (Defence) in the New York proceedings was struck out and judgment was entered for the liquidator of Nassau in the amount sought. The liquidator of Nassau then sought to enforce the New York judgment in Bermuda, but failed in that application for two reasons:

1. It would be contrary to public policy for the Bermuda Court to enforce the New York judgment because the liquidator of Nassau was in continuing contempt of an order of the Supreme Court of Bermuda expressly prohibiting him from pursuing the very action which he sought to enforce judgement in; and
2. The judgment sought to be enforced was obtained in breach of English and Bermudian notions of substantial or natural justice, Ardra not being permitted to defend unless it posted a sum of security which the New York Court had no reason to think it could pay and which the Bermudian court found as a fact it could not pay within the required time frame.

It is to be noted that the Supreme Court of Bermuda in rendering its judgment specifically pointed out that only two years earlier the rules relating to enforcing foreign judgments in Bermuda (outside of the Judgments (Reciprocal Enforcement) Act 1958) had been reiterated and that in that case a judgment of the Supreme Court of New Hampshire had been enforced in Bermuda. The court also pointed out that it was plain that at each stage, each side was attempting to use the courts of the two countries to compel litigation in their respective domestic forum and that in such a case there is always the risk that the court of one country will be

manipulated by the parties into a false position of apparent conflict with the court of the other. The Supreme Court of Bermuda, however, recognized that there exist well established rules for regulating such conflict and deciding where and according to whose law, any matter is appropriate to be tried.

Eventually, the liquidator of Nassau sought to pierce the corporate veil of Ardra by way of New York law. In an action by the liquidator of Nassau against Tiber in the United States District Court for the Eastern District of Pennsylvania, the court held that the unique facts of the litigation made it inappropriate to apply the law of Bermuda, the place of incorporation, for the purposes of piercing Ardra's corporate veil. The reason for this finding (according to the court) was that Ardra was incorporated in Bermuda as an "exempt" company, meaning that Ardra could only accept business from outside Bermuda and could not conduct business with Bermuda residents or companies and thus that the (American) test of the traditional interests of the place of incorporation was greatly diminished. The court also found as a fact that Ardra's only business was with a New York company, Nassau, which conducted business of insurance, a highly regulated field in New York and (somewhat surprisingly) that the Supreme Court of Bermuda had refused to enforce the judgment underlying the litigation. The court went on to say that on the facts described above, particularly the lack of comity by Bermuda on an issue integral to the litigation, enforcement of the underlying judgment, led that court to conclude that the New York courts would apply an interest analysis to determine which law should be applied to the corporate veil piercing claim against Ardra and concluded that New York law was the appropriate law.

It is important to remember that the Federal court's decision was based squarely on section 1505(a)(1) of the New York Insurance Law. That provision of law required that, within the context of a holding company scheme, transactions involving a controlled insurer (Nassau) must be fair and equitable. The transactions between Nassau and Ardra were not fair and equitable to Nassau, according to the court. The court permitted the liquidator of Nassau to pierce the corporate veil of Ardra to reach the personal assets of the controlling shareholders without any allegation of fraud; the determination was that the transactions between Nassau and Ardra were not fair and equitable to Nassau and that that was sufficient to pierce the corporate veil of Ardra as a matter of New York law, and to hold Ardra's shareholders liable for Ardra's debt.

Whilst it is self-evident that the prolonged litigation in two

jurisdictions and the conflicting decisions of the various courts in those jurisdiction are unsatisfactory in the context of the global business (and particularly insurance) climate prevailing today, it is to be hoped that the decision to pierce Ardra's corporate veil will in future be held to be strictly based on the New York Insurance Law and that the decisions of the US courts will not be enlarged to create a general exception in relation to foreign companies who do business with American companies. It is to be hoped that two of the three reasons given by Justice Dubois of the US District Court for the Eastern District of Pennsylvania are to be taken at face value: (1) The unique facts of the case make it inappropriate to apply the law of Bermuda; and (2) Ardra's only business was with a New York company. The third reason given by Justice Dubois, that the Supreme Court of Bermuda has refused to enforce the judgment given in New York as a result of striking out Ardra's Answer for failure to provide Pre-Answer security (which it could not provide), whilst couched as a reason for the decision may well be found in future to have been merely a passing remark which was not necessary for the decision.

The information contained in this article represents the author's view of the various legal decisions and is not intended to be an exhaustive analysis of the litigation discussed. The author's view of the American decisions discussed should not be taken to be an opinion in respect of American law: the author is not qualified to practice law in any of the United States.

For further information regarding an action against shareholders for the defaults of the company in Bermuda please contact Paul A. Harshaw, Senior Associate at paharshaw@milligan.bm

WHEN CAN DIRECTORS VALIDLY REFUSE TO TRANSFER SHARES?

Register of Members

Under the Companies Act of Bermuda 1981 (the "Act"), Bermuda exempted companies must maintain a register of members at the registered office of the company. The register of members must include the details on the shareholder including the address, number of shares held by the shareholder and the amount paid for the shares held. The register of members must also include the date that the shareholder became and ceased to be a member of the company for a period of one year thereafter. The register of members must be open to inspection by the shareholders of the Company or persons entitled to inspect it.

Directors' Discretion - Share Transfers

Generally, standard bye-laws of Bermuda exempted companies give directors absolute discretion to validly refuse to register a transfer of shares and the directors are under no obligation to give reasons for their refusal.

In *Re Smith & Fawcett, Ltd.* [1942] 1 ALL ER 542 the Articles of Association (the bye-laws) provided that “the directors may at any time in their absolute and uncontrolled discretion refuse to register any transfer of shares.” In this particular case, the directors refused to register the shares of the appellant unless a certain condition was satisfied, which it was not. The court held “having regard to the terms of the article, the only limitation on the directors’ discretion was that it should be exercised bona fide in the interests of the company. There was no ground for saying that the directors’ refusal to register the transfer was not due to a bona fide consideration of the interests of the company as seen by them.”

Subsequently, the courts have reiterated the position of the absolute discretion of directors to refuse to register a share transfer in the case of *Charles Forte Investments, Ltd. v Amanda* [1963] 2 ALL ER 940.

The issue has been raised in the Bermuda Court of Appeal in *Mayfair Limited vs. Edmund Gibbons Limited et al*, Civil Appeal No. 9, 1985 and the Bermuda courts have followed the English cases. In the Bermuda case, there was a bye-law which put a condition on a member’s right to sell shares to a person of his choice. The courts construed this bye-law strictly and the directors of the company were bound by it.

The Bermuda courts have held that the discretionary power is of a fiduciary nature and it will be assumed that the discretionary power is being exercised in the interests of the company unless there is clear evidence to the contrary. The absolute discretion must be exercised in the interest of the Company.

The directors of a Bermuda company are also under a duty to refuse to transfer shares in a company where the transferee has given false information regarding his identity and stating falsely the consideration given for the shares.

Directors of a Bermuda company may also validly refuse to

register the transfer of shares where the bye-laws of the Company have placed restrictions on the transfer of shares. Typical restrictions include:

1. the consideration for the shares has not been fully paid;
2. where the transferee is a company, that company carries on unlawful business;
3. the directors generally disapprove of the transferee.

Any such refusals must be by resolution of the board of directors at a properly convened meeting, otherwise the power to refuse has not been exercised properly and the transferee has a statutory right to be registered as a new member of the company.

When Directors Refuse to Register a Share Transfer

Should the directors refuse to register a transfer of shares, they must give the transferor and the transferee, notice of the refusal within 3 months of the date on which the transfer was lodged with the company. If this is not done, the company and every officer of the company will be liable to a fine.

If the directors fail to exercise their discretion within a reasonable time, they will lose their power to refuse registration. As the law requires the refusal to be notified to the transferee within three months, the reasonable time allowed for the decision would not generally be longer than three months.

Where the decision was made within the stipulated time but the directors failed to notify the intended transferee of their decision within the three months, it has been suggested that this omission could be so fundamental that the directors would lose the power to exercise the discretion to refuse to register that transfer of shares.

This could ultimately expose the directors to civil liability from the transferee, but it would not make the directors' power to refuse to register a transfer, invalid.

Share Transfers in Local Companies

Under Section 118 of the Act, directors of a Bermuda local company are not allowed to transfer shares if they are aware that the transferee is non-Bermudian and that transfer would amount to a disproportionate number of shares being beneficially owned by non-Bermudians contrary to the Third schedule of the Act. Prior written consent needs to be obtained by the Minister of Finance for Bermuda.

Share Transfers in Public Companies

As far as Bermuda public companies are concerned, the Bermuda Stock Exchange (BSX) has its own listing regulations. Appendix 4 of the General Listing Regulations states:-

“Fully paid shares must be free from all liens and have free transferability on the BSX (except where s118 of the Act applies or any other statutory restriction on transfers).”

These are regulations and not statutes; however public companies wishing to register with the BSX are obliged to adhere to the regulations

The contents of this newsletter are not intended to be a complete statement of the law on any subject and should not be used as a substitute for legal advice in specific fact situations. If you require more detailed information or advice concerning a specific fact or situation, you are invited to contact one of the above named for that purpose. Lynda Milligan-Whyte & Associates cannot accept any liability or responsibility for loss occurring as a result of anyone acting or refraining from acting in reliance on any material contained in this newsletter.