

Taking of Security over Shares in a Cyprus Limited Liability Company

Introduction

The taking of security over shares in a Cyprus limited liability company (the “Company”) is governed by the Cyprus Company Act, Cap 113 (“Cap 113”) and the Cyprus Contract Law, CAP 149. The taking of such security over the shares in a Company (the “Pledged Shares”) is usually in the form of a pledge agreement (the “Share Pledge Agreement”) executed between the registered owner of the Pledged Shares (the “Pledgor”) and the individual or legal entity in whose favor the pledge is executed (the “Pledgee”).

It is important to note that Cap.113, is based on the UK Company Law and one can say that it is virtually a copy of the English 1948 Companies Act subject to some amendments that have been made during the last few years. Similarly Cyprus Contract Law is identical to the English Contract Law and follows very closely the UK precedents.

Procedures for taking and perfecting a Cyprus Pledges over company shares

A Share Pledge Agreement is executed between the Pledgor and the Pledgee which provides that certain documentation, as outlined below, is delivered to the Pledgee concurrently with the execution of the Share Pledge Agreement. The Pledgor grants to the Pledgee the following documentation:

- a) The original share certificates representing the Pledged Shares;
- b) Undated blank instruments of transfer of the Shares duly executed by the Pledgor;
- c) An irrevocable proxy and power of attorney in respect of the Pledged Shares from the Pledgor;
- d) Undated, signed letters of resignation from each of the directors and secretary of the Company;
- e) A certified copy of a resolution of the board of directors of the Company approving the pledge of the shares under the Share Pledge Agreement and the transfer of the shares;
- f) A letter of authority and undertaking from each of the directors and secretary of the Company.

The Share Pledge Agreement should impose an obligation on the Pledgor to procure that forthwith, upon receipt by the Company of a notice from the Pledgee or on its behalf giving notice of the pledge evidenced by the Share Pledge Agreement and

attaching a certified copy of the said agreement, the Company will cause a memorandum of pledge to be made in its register of members against the Pledged Shares and deliver to the Pledgee a certificate that such memorandum was made in the form of the certificate and procure that the provisions of section 138(2) of the Cyprus Contract Law, CAP 149, are fully complied with regard to the Share Pledge Agreement. This also serves as a safeguard in the effect of unauthorized or fraudulent execution of the blank instruments of transfers since the secretary is aware of the Share Pledge Agreement and who should be in possession of the said documentation.

In order to ensure the enforceability and legality of the securities created pursuant to the Share Pledge Agreement they must be registered with the Registrar of Companies in Cyprus pursuant to sections 90 and 91 of the Cyprus Companies Law (Cap 113) within 21 calendar days of the creation of the security interest under each of these Agreements otherwise they will be void against a liquidator, administrator or creditor of the Company.

Procedures for termination of a Pledge

The termination of a Pledge may be determined in the Share Pledge Agreement and can be terminated on the earlier of:

- (i) the date of discharge by the Pledgor of the secured obligations in accordance with the Share Pledge Agreement or any other agreement as the case may be; or
- (ii) the date when the mutual written agreement of the parties to terminate the agreement is executed and delivered by all Parties, unless another date is agreed by all parties in such termination agreement; or
- (iii) the date on which the Pledgee serves a written termination notice to the Pledgor (in the event that the Pledgee chooses in its sole discretion not to enforce the Share Pledge Agreement); or
- (iv) upon enforcement of the pledge by the Pledgee.

In the event of termination of the Pledge, the Pledgee shall return the share certificates regarding the Pledged Shares and any other documents provided to the Pledgee under the Share Pledge Agreement and execute and submit (or procure the execution and submission) of any such documents or instruments as may be required to remove the encumbrance in favour of the Pledgee from the Charged Shares.

Any registration of the charge at the Cyprus Company Registrar will be cancelled by filing a cancellation notice.

A notification should also be sent to the secretary of the Company in order to cancel the memorandum of pledge that was made in its register of members against the Pledged Shares

Foreclosure on the Pledged Shares

The foreclosure takes place by dating the Instrument of Transfer and the Pledged Shares are transferred in either the name of the Pledgee or in the name of such third party that the Pledgee shall nominate (either by transfer or sale). And relevant notification is given to the secretary of the Company who records the said transfer in the Register of Members, cancels the previous Share Certificates and issues new ones as per the instructions of the Pledgee. The secretary will also ensure that the relevant changes are made at the Company Registrar.

There is no statutory requirement under Cyprus Law for the public sale of the shares unless otherwise stipulated in the Pledge Agreement. However if the Pledgee proceeds and sells the shares it has a common law obligation to obtain a reasonable market price at the relevant time.

Shares held by a Nominee

If the shares are held by a nominee the procedure is not different. However it is preferable for the Pledgee to obtain a consent letter from the ultimate beneficial owner that it consents to the execution of the said Share Pledge Agreement by the Pledgor. And if the beneficial owner is a legal entity then a Board Resolution should also be obtained approving this.

Second/Subsequent Pledge

In the case of a second or subsequent charge over shares that have already been pledged the procedures will be very different since no instrument of transfer or share certificates can be given to the second/subsequent pledgee. It is important to note that only an equitable charge can be created over those shares and any enforcement proceedings need a court order.

The taking of second and/or subsequent pledges over Company shares is not a legal practice that is followed in Cyprus.

Other key issues for taking and perfecting Cyprus share pledges.

In addition to the above it is important for the Pledgee to ensure that:

- (a) the Articles of Association of the company whose shares are to be pledged permit for the granting of such a security and there are no specific restrictions;
- (b) all the corporate approvals/board resolutions have been obtained;
- (c) there are no other charges registered against the Pledged Shares;
- (d) the Pledged Shares are fully paid at the time of taking the security.