



## **SUMMATIVE (FORMAL) ASSESSMENT: MODULE 5A**

### **BERMUDA**

This is the **summative (formal) assessment** for **Module 5A** of this course and is compulsory for all candidates who **selected this module as one of their elective modules**.

**The mark awarded for this assessment will determine your final mark for Module 5A.** In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

## **INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT**

**Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.**

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
4. You must save this document using the following format: **[studentID.assessment5A]**. An example would be something along the following lines: 202122-336.assessment5A. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words “studentnumber” with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked.**
5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
6. The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
7. Prior to being populated with your answers, this assessment consists of **7 pages**.

## **ANSWER ALL THE QUESTIONS**

### **QUESTION 1 (multiple-choice questions) [10 marks in total]**

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

#### **Question 1.1**

When is a Bermuda company deemed to be unable to pay its debts under section 161 and section 162 of the Companies Act 1981?

- (a) Only when it is balance sheet insolvent.
- (b) Only when it is cash flow insolvent.
- (c) When it is balance sheet insolvent and cash flow insolvent.
- (d) When it is either balance sheet insolvent, or cash flow insolvent, or a valid statutory demand has not been satisfied within a period of three weeks after service on the company's registered office, or if a judgment in favour of a creditor remains unsatisfied.**

**CORRECT**

#### **Question 1.2**

**Who may appoint** a Provisional Liquidator over a Bermuda company?

- (a) A secured creditor.
- (b) An unsecured creditor.
- (c) The company itself (whether acting by its directors or its shareholders).
- (d) The Supreme Court of Bermuda.**

**CORRECT**

#### **Question 1.3**

**In what order** are the following paid in a compulsory liquidation under Bermuda law?

a) Preferential creditors; b) unsecured creditors; c) costs and expenses of the liquidation procedure; d) floating charge holders.

- (a) a, b, c, d
- (b) c, d, a, b
- (c) c, a, d, b**

(d) a, c, d, b

CORRECT

#### Question 1.4

**What percentage** of unsecured creditors must vote in favour of a creditors' Scheme of Arrangement for it to be approved?

(a) Over 50% in value.

(b) 50% or more in value.

(c) Over 75% in value.

(d) A majority of each class of creditors present and voting, representing 75% or more in value.

CORRECT

#### Question 1.5

What is the **clawback period** for fraudulent preferences under section 237 of the Companies Act 1981?

(a) Two (2) years.

(b) One (1) month.

(c) Twelve (12) months.

(d) Six (6) months.

CORRECT

#### Question 1.6

What types of transactions are reviewable in the event of an insolvent liquidation?

(a) Only fraudulent conveyances.

(b) Only floating charges.

(c) Only post-petition dispositions.

(d) All of the above.

CORRECT

#### Question 1.7

How many insurance policyholders are required to present a petition for the winding up of an insolvent insurance company under section 34 of the Insurance Act 1978?

- (a) At least five (5).
- (b) One (1) is sufficient.
- (c) At least 10 or more owning policies of an aggregate value of not less than BMD 50,000.
- (d) At least 10.

CORRECT

### Question 1.8

Where do secured creditors rank in a liquidation?

- (a) Behind unsecured creditors.
- (b) Behind preferential creditors.
- (c) Behind the costs and expenses of liquidation.
- (d) In priority to all other creditors, since they can enforce their security outside of the liquidation.

CORRECT

### Question 1.9

Summary proceedings against a company's directors for breach of duty (or misfeasance) may be brought by a liquidator under which provision of the Companies Act?

- (a) Section 237 of the Companies Act 1981.
- (b) Section 238 of the Companies Act 1981.
- (c) Section 247 of the Companies Act 1981.
- (d) Section 158 of the Companies Act 1981.

CORRECT

### Question 1.10

What is a segregated account representative of an insolvent Segregated Accounts Company required to do under section 10 of the Segregated Accounts Companies Act 2000?

- (a) Resign immediately.
- (b) File a Suspicious Transaction Report forthwith.
- (c) Make a written report to the Registrar of Companies within 30 days of reaching the view that there is a reasonable likelihood of a segregated account or the general account becoming insolvent.
- (d) Notify the directors, creditors and account owners within 28 days.

**CORRECT**

**QUESTION 2 (direct questions) [10 marks]**

**Question 2.1 [maximum 4 marks]**

In what circumstances may a Provisional Liquidator be appointed?

Pursuant to Section 170(2) of the Bermuda Companies Act, 1981, a provisional liquidator may be appointed in respect of the period between a winding-up petition being presented and the listed hearing. Such circumstances which may be appropriate for a provisional liquidator to be appointed are if there is any risk of assets dissipating during this time frame, thereby, safeguarding the assets through the appointment. Another reason could be to allow Court supervised restructuring to be considered whilst being protected by the automatic stay brought about by the appointment of the provisional liquidator. This approach supports both formal and informal restructuring plans that would stand a good chance of success, with the support of the creditors.

**CORRECT – 4 MARKS**

**Question 2.2 [maximum 2 marks]**

When can rights of set-off be exercised after the commencement of a liquidation of a Bermuda company?

Pursuant to Section 37 of the Bankruptcy Act 1989, which is applicable to companies in liquidation, there is a 'mandatory set off' provision for liquidation in Bermuda. This applies to any mutual credits, mutual debts or other mutual dealings between the debtor company and a creditor. Any sum due from one party shall be set off against the other party so that no more shall be paid by either party, provided no notice of insolvency was given at the time of the debt being incurred.

**CORRECT – 2 MARKS**

**Question 2.3 [maximum 4 marks]**

Describe **three possible ways** of taking security over assets under Bermuda law?

There are several ways by which a creditor can take security over assets under Bermuda Law (which follows English Common Law), including fixed charge, floating charge, legal mortgage and pledge. I look at three in more detail below:

The first is a legal mortgage. Under a legal mortgage, the legal title of the debtor's property is transferred to the creditor as security for the debt. Whilst the debtor retains possession of the property, the legal title is only regained by way of full payment and satisfaction of the debt.

As an alternative, when a fixed charge is used, the creditor does not take over legal or beneficial ownership of the property. However, in having a fixed charge over the property, the creditor has a right to take possession of and sell the property if the creditor defaults on the agreement. The debtor cannot take any action to sell the property without the consent of the creditor and in the event of sale, the proceeds of sale are applied to the fixed charge holder in the first instance, as priority to other unsecured creditors.

The third example is a floating charge which, unlike the fixed charge, is not 'fixed' to one specific asset. Instead it 'floats' and covers a variety of assets under its security. Floating charges tend to be applicable in respect of movable and certain intangible property. Whilst the debtor can sell assets without the consent of the floating charge holder, if the debtor at any point defaults on the agreement, the floating charge will crystallise and become a fixed charge over the remaining assets.

CORRECT – 4 MARKS

### **QUESTION 3 (essay-type questions) [15 marks in total]**

#### **Question 3.1 [maximum 8 marks]**

Write a brief essay on the basis upon which foreign liquidators are granted recognition and assistance in Bermuda.

It is very common in Bermuda for Bermuda's international business companies, which are often exempt companies due to their foreign exchange listed status, to find themselves being placed into compulsory liquidation by two jurisdictions simultaneously – both in Bermuda and in the jurisdiction in which they conduct their business. In determining which Court shall be recognised as the primary Court, whilst Bermuda has not adopted the guidance set out in the UNCITRAL Model Law, it does use Common Law to consider all circumstances of the case, including the company's centre of main interests. The law of Bermuda is based on the common law legal system of England and Wales. In fact, given there is no specific Bermuda legislation pertaining to the recognition assistance for foreign liquidators, all recognition and assistance for foreign liquidators is governed under common law powers.

The Supreme Court of Bermuda has issued Practice Directions centred around court-to-court communications and cooperation, providing guidelines for the same. In particular, certain landmark cases have led to protocol being agreed on an *ad hoc* basis, seen for example in Practice Direction Circular No 6 of 2017 and Practice Direction, Circular No 17 of 2007. Bermudian Courts have common law power to "provide assistance by doing whatever it could have done in the case of a domestic insolvency", however, following the two landmark cases I explain in further detail below, there has been much debate as to the extent those powers being enforceable.

In the landmark case of *PricewaterhouseCoopers v Saad Investments Company Limited*, the Privy Council ruled that the Bermuda Court does not have jurisdiction to wind up overseas companies, 'save for certain statutory exceptions', which in this particular case did not apply. In this case, Saad Investments Company Limited was subject to winding-up proceedings in the Cayman Islands. PricewaterhouseCoopers were subject to a demand for file disclosure, the full extent to which they objected to. It was the Cayman liquidators whom sought an ancillary winding up order in respect of Saad from the Bermuda court and as a result of the refusal to disclose said files, a winding up order was subsequently made against PricewaterhouseCoopers in Bermuda. The Privy Council decision that the Bermuda Court does not have jurisdiction to wind up overseas was further supported by the fact that the winding up order against PricewaterhouseCoopers had only been made to obtain information from them.

In the case of *Singularis Holdings Limited vs PricewaterhouseCoopers*, the Cayman liquidators of Singularis instead obtained a disclosure Order from the Bermuda Court, for Singularis to submit their files. However, the disclosure Order was overturned by the Privy

Council on the basis that the Cayman Court has no jurisdiction to grant an Order to the liquidator of a Cayman company for disclosure of documents to another party of another jurisdiction.

Notwithstanding these two rulings, the Bermuda court is likely to recognise winding up orders from foreign courts if there is a sufficient connection between the foreign court's jurisdiction and the foreign company which makes it the most convenient jurisdiction to have a winding up order. It is also likely to grant recognition if there are documents, assets or liabilities within Bermuda or if business was conducted in Bermuda. It will also be considered if there is no public policy reason under Bermudian Law to the contrary.

It should be noted that the Privy Council has put emphasis on the importance of the development of common law to assist foreign liquidators and that it certainly does depend on the facts of each case and the nature of the request to the Bermuda Court in the powers they are being asked to exercise. Further, the Bermuda Court would not have the power to assist foreign liquidators to do something which they would not otherwise be able to do under the law by which they were appointed; and it must be consistent with the substantive law and public policy of the Bermuda Court.

GOOD EFFORT – 6 MARKS – ANSWER COULD HAVE BEEN MORE FOCUSED IN RESPONSE TO THE SPECIFIC QUESTION

**Question 3.2 [maximum 7 marks]**

Write a brief essay on the circumstances in which a foreign Court judgment **will not be** registered or enforced in Bermuda. Also consider and address the question as to whether a foreign Court-sanctioned Scheme of Arrangement might be registered or enforced in Bermuda.

A foreign judgment is a judgment of a foreign Court. Stand alone, it has no direct legal effect in Bermuda and cannot be enforced in Bermuda without appropriate steps being taken to make it legally enforceable.

Dependent on the nature of the foreign judgment or the jurisdiction to which it was made, either statutory rules or common law rules would be applicable in seeking the recognition or enforcement of the foreign judgment in Bermuda.

The Bermuda Courts will only recognise a foreign money judgment where it is covered under the 1958 Act, therefore, if it does not meet this requirement, it will not be registered or enforceable. Within the legislation of the 1958 Act, a judgment of a Superior Court of the United Kingdom can be registered, however, if the judgment is of an inferior foreign Court then it cannot be registered or enforced under the 1958 Act. This is also true even if proceedings have been transferred to a superior court to be enforceable, as seen in the case of *Crossborder Capital Ltd v Overseas Partners Re Ltd* in 2004, whereby a transfer to the High Court for enforcement purposes was not sufficient for the foreign judgment to be registered or enforced in Bermuda under the 1958 Act.

Under the common law rule, the foreign judgment will not be enforceable if the court of law where the judgment was obtained did not have jurisdiction over the debtor. In addition, if the judgment was obtained by fraud or is in respect of taxes, fines or penalties, then it will equally not be enforceable.

If in any way the enforcement of the judgment would be incompatible with public policy in Bermuda then enforcement of the judgment would be denied. The rules of natural justice need also apply and enforcement is not granted unless this is adhered to.



In Bermuda, there have been a number of parallel running schemes of arrangement, which are sanctioned by the Court in Bermuda and the appropriate foreign Court. A Scheme of Arrangement is a formal procedure which may be used to reorganise the business of the debtor with a view to its continued trading. Whilst they occur often, it has been emphasised by a number of Courts that a cost benefit analysis of having parallel proceedings must be considered, having regard to the “Rule of Gibbs” and whether a debt can be validly discharged in the absence of a claim for foreign debt.

It is uncertain whether a foreign scheme of arrangement can be recognised and enforced in Bermuda as a matter of common law, unless such a parallel scheme of arrangement has been implemented. Whilst there has been some willingness from the Supreme Court of Bermuda to recognise these foreign schemes, it still stands to question what may happen in the case of a particularly contentious or complex scheme of arrangement.

GOOD EFFORT – 6 MARKS – COULD HAVE BEEN SLIGHTLY CLEARER ABOUT THE TWO METHODS FOR ENFORCEMENT OF FOREIGN JUDGMENTS AND EXCEPTIONS.

**QUESTION 4 (fact-based application-type question) [15 marks in total]**

ELBOW LIMITED (“the Company”) was incorporated in 2019 as an exempt Bermuda company, as the parent company in a group of companies, with a direct subsidiary incorporated in the British Virgin Islands, and with indirect subsidiaries incorporated in Hong Kong and with offices and a substantial business presence in Hong Kong. The Company was formed with the intention of investing, through subsidiaries, in illiquid assets in the form of litigation funding loans and distressed debt in Asian markets.

Having funded, through one of its subsidiaries, a hopeless court case in Hong Kong against VICTORY LIMITED, a costs order was made by the Hong Kong Court against ELBOW LIMITED in favour of VICTORY LIMITED in the sum of USD 2 million, payable in full within 14 days.

At the due date for payment of the costs order to VICTORY LIMITED, ELBOW LIMITED’s assets were fully invested and its investments, although illiquid, were valued in the aggregate sum of USD 10 million.

The Company’s directors decided that it was in the best interests of ELBOW LIMITED and its shareholders not to satisfy the Hong Kong Court judgment and not to liquidate any of its assets to cash given the risk that an urgent “fire-sale” would completely destroy the value of those assets, and in circumstances where ELBOW LIMITED did not consider that the Hong Kong Court judgment would be enforceable against it in Bermuda.

The Company’s directors subsequently borrowed an additional USD 5 million from its bank, LENDBANK, secured by way of a floating charge against all of its shares and the assets of its subsidiaries. Out of the USD 5 million received from LENDBANK, ELBOW LIMITED’s directors immediately paid themselves a bonus payment of USD 2 million and they also paid a dividend to the Company’s shareholders in the sum of USD 3 million.

VICTORY LIMITED only found out about these transactions two weeks later, through a report received from a disgruntled former employee of ELBOW LIMITED.

**Using the facts above, answer the questions that follow.**

**Question 4.1 [maximum 7 marks]**

What actions could VICTORY LIMITED take to try to recover its cost order against ELBOW LIMITED? Please consider (a) the jurisdictions in which it could take such action, bearing in mind the potential need for enforcement; (b) the defendants against whom it could take such action; (c) the pros and cons of litigation as opposed to insolvency proceedings; and (d) the causes of action that may be available against the various potential defendants.

Elbow Limited could be subject to winding up proceedings in Hong Kong, being the jurisdiction in which it operates with proceedings in Bermuda running parallel. Victory Limited is a creditor with an unsatisfied costs order, which can now form the basis of the issuance of a statutory demand and petition to wind up Elbow Limited, both in Bermuda and in Hong Kong. However, prior to doing so, it will be necessary for Victory Limited to have their judgment recognised in Bermuda, as it has no direct legal effect in Bermuda on its own. There should be no issue faced by Victory Limited in doing this as Hong Kong are named in the First Schedule to the Reciprocal Enforcement of Judgement Act 1958, which means the statutory rules apply to the registration and enforcement of the foreign money judgment in Bermuda.

The defendant in the proceedings would be the company, Elbow Limited, in the case of presenting a winding up petition, on the basis of an unsatisfied judgment. In this instance, insolvency would be preferred over litigation as the funds have already been put out of reach of the creditors and it would be more effective to pursue the directors through the liquidation of the company in clawing back those transactions. Though litigation is likely to be a cheaper course of action, it would not necessarily result in any financial recoveries, just action against the defendants.

Further, it is important to note that, pursuant to Section 239 of the Companies Act 1981, the floating charge of Lendbank on the undertaking or property of Elbow Limited would be considered invalid if it occurred within 12 months of the commencement of winding up proceedings. Therefore, another benefit of Victory Limited pursuing insolvency proceedings would be that it would take out the validity of the floating charge which may otherwise have had preference over the liquidation proceeds in accordance with the waterfall priority of payments should winding up occur at a later date and of course render the charged assets unencumbered.

Further, the Company's directors "decided that it was in the best interests of Elbow Limited and its shareholders not to satisfy the Hong Kong judgement". However, given the Hong Kong judgment rendered Elbow Limited into the 'zone of insolvency', the directors have a duty to act in the interests of the creditors and not just the company itself. Accordingly, the directors can be pursued for breach of fiduciary duty as they did not act honestly, in good faith and in the best interests of the creditors. The directors could be personally liable for this action and therefore litigation against the directors individually could also be considered.

In addition, pursuant to Section 247 of the Companies Act 1981, the directors could also be pursued for and personally liable for mis-applying the money of the company through the payments made to the directors as a bonus payment and the dividend to the shareholders. This constitutes misfeasance and breach of trust. In addition, Elbow Limited could not lawfully have made this dividend to the shareholders, thereby returning capital, without an approved reduction of capital, share repurchase or dividend. Section 54 of the Companies Act provides that Elbow Limited should not have paid a dividend to its shareholders as they absolutely had to have had reasonable grounds to believe that the company had debts, being the debt to Victory Limited, that it could not have paid as it fell due.

It could even further be argued under the miscellaneous provisions of Sections 243 to 248 of the Companies Act 1981 that the directors actually acted with the intent of defrauding both Lendbank (as they ought to have known the risk of being wound up, thereby, causing the floating charge to be invalid), they misappropriated the funds for the benefit of themselves and

the shareholders, putting these funds out of reach of the creditors and they also could be accused of defrauding Victory Limited by intentionally choosing not to repay the debt.

Finally, the payments to the directors and the shareholders, which were made immediately upon receiving the money from Lendbank would be considered fraudulent preferences pursuant to Section 237 of the Companies Act in the event of winding up. In the case of compulsory winding up, the relevant date is actually the date of the presentation of the petition to the Supreme Court of Bermuda therefore, should Victory Limited pursue this course of action then the transfers will be considered invalid as it was carried out with the dominant intention to preferring their own interests over the amount owing to Victory Limited.

### GOOD, COMPREHENSIVE ANSWER – 7 MARKS

#### **Question 4.2 [maximum 8 marks]**

To what extent would it be open to ELBOW LIMITED to try to take steps to restructure its debt obligations? How and where would it do so? Consider whether it would be more appropriate to take steps before the Hong Kong courts, the Bermuda courts, or both and, if so, why? Also consider whether it would make any difference if the debt restructuring involved a “debt-for-equity” swap, i.e. the creditors of ELBOW LIMITED would be issued new shares in the Company in exchange for cancellation of their debt, with existing shareholders’ shares in the Company being cancelled.

A Scheme of Arrangement is Bermuda’s only formal rescue procedure, and is set out in Sections 99 and 100 of the Companies Act; its purpose is to aid companies in restructuring its debt. It may be used to reorganise the business with a view to its continued trading and can be initiated by the company itself or a creditor. In addition, a Scheme of Arrangement may reorganise the company’s capital and may be used to implement a debt for equity swap and there is a specific provision that the Court has jurisdiction to make for this in the order sanctioning the scheme.

This is a Court supervised process. A Scheme of Arrangement in Bermuda follows a similar course as that of a Hong Kong Scheme of Arrangement under Part 13, Division 2 of the new Companies Ordinance. Conducting the Scheme of Arrangement in Bermuda is the most straightforward and cost-effective way of restructuring Elbow Limited, being a company incorporated in Bermuda but with business dealings in another jurisdiction. Given Bermuda’s tax neutral offshore location, its Scheme of Arrangement allows companies to restructure without tax liability complications.

This is not a formal insolvency process, and the directors of the company would retain their powers and duties, albeit, under the supervision of the Scheme of Arrangement Supervisor. It is absolutely an option that the Scheme of Arrangement can be utilised to provide a debt for equity swap, an option which may very well be appealing to the creditors due to the relatively high level of assets Elbow Limited has. A Scheme of Arrangement must as a minimum include a compromise arrangement for the company and its creditors so a debt for equity swap can be a good debt reduction strategy.

An important point to consider in the case of Elbow Limited is that all of its assets are fully invested and are therefore illiquid. Where there are liquidity issues, it may face difficulty in pursuing a Scheme of Arrangement due to being susceptible to litigation or compulsory winding up petitions, which we know is a risk here due to the disgruntled position of Victory Limited. Where this is a concern, the Court would be called upon to implement ‘soft touch’ provisional liquidators to protect the proposed scheme, who may then apply for a stay

preventing such creditor action. If a provisional liquidator is appointed, these proceedings can be readily recognised in Hong Kong if needed for global restructuring purposes.

That being said, a Scheme of Arrangement requires the approval of the majority of the creditors and it therefore must be on such terms that creditor approval can be obtained, albeit, unanimous consent is not necessary, only majority, being 75% of each class of creditor. If there is a minority of dissenting creditors, it is possible to 'cram down' that class of stakeholder. In this instance, we do not have all of the information available to determine whether there are other creditors who may influence the vote to conclude whether or not a Scheme of Arrangement is a viable option.

In cases like that of Elbow Limited where there is a lack of liquidity, they may look into entering into funding arrangements with those interested in the outcome of the arrangement, namely creditors. Those funding liabilities would typically be expected to be repaid by the company but the specific terms of the funding agreement would be subject to the Court's approval.

GOOD ANSWER – 8 MARKS

TOTAL – 47 MARKS OUT OF 50

**\* End of Assessment \***