



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?

- When there is a risk of assets dissipation between the date of presentation of the petition to wind-up and final hearing.
- When a restructuring is capable of being achieved under the supervision of the court, the court may appoint a provisional liquidator triggering a statutory stay of proceedings against the company. During this period, the board of directors attempts to work out a restructuring scheme under the supervision of the “soft-touch” provisional liquidator.
- When there is a good *prima facie* case that a winding up order will be made in the end (at the final hearing). For example, where there is a contest to the petition to wind-up, and the court is of the view that there is a good *prima facie* case that a winding up order will be granted.
- Where the court considers that the company should be placed in the hands of a provisional liquidator for independent supervision and control.

GOOD ANSWER – 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?

- When there have been mutual credits, mutual debts, or mutual dealings between the debtor (company in liquidation) and a creditor.
- However, the rights of set-off is only available (a) if a creditor has no knowledge (notice) of the insolvency of the debtor (b) where the debts relate to “pre-existing” debts - that is the debts existed prior to the commencement of the liquidation (c) the transaction giving rise to the set-off was not due to a fraudulent conveyance or fraudulent transaction and (d) there is mutuality of dealings between the parties (parties are the same) to the transaction.

GOOD ANSWER, COULD HAVE BENEFITTED FROM CITATION OF RELEVANT STATUTORY PROVISION – 2 MARKS

Question 2.3 [maximum 4 marks]

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

- Security over assets may be obtained by (a) legal mortgage (b) equitable mortgage (c) fixed charge (d) floating charge (e) pledge and (d) lien.
- Legal mortgage – This involves transfer of legal title from the debtor (usually a borrower) to a creditor (usually a lender). The debtor retains possession of the assets and may

redeem (regain) the legal title to the property upon full payment of the debt (obligations) to the creditor.

- Equitable mortgage – The legal title remains with the debtor, but the beneficial ownership belongs to the creditor. A third party has no notice the existence of the creditor’s beneficial interest.
- Fixed charge – The legal and beneficial interest remain with the debtor, but it gives the creditor the right to take possession or right of sale in the event of default by the debtor.
- Floating charge – The charge is “floating” in that it is a charge over a class of asset where the debtor is able to use the assets without the consent of the chargee until a “crystallisation” event. The floating charge not over a specific (identifiable) asset, but a class of asset. An example is inventory or receivables (the floating charge specifies the class of assets (for example, inventory) but not any specific inventory). The legal and beneficial interests remain with the debtor at the creation of the floating charge until crystallisation.
- Pledge – This involves the creditor taking possession of the security asset until the debt is paid. An example is the share of a subsidiary.
- Lien – A creditor takes possession of the property of a debtor (not for the purpose of creating a security) as “security” until a certain obligation is discharged by the debtor. An example is a car mechanic keeping possession of the car until the costs of car repair is fully paid.

GOOD ANSWER, LONGER THAN NEEDED – 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.

The court may grant recognition of a foreign liquidator when there is “sufficient connection” between the foreign court and foreign company. Further, the court is of the view that it is the “most convenient” jurisdiction to have been granted the winding-up order and appointment of the foreign liquidator.

The criteria on whether Bermuda will grant recognition includes - (a) when there are assets and liabilities of the foreign company in Bermuda (b) when the business of the foreign company has been conducted in Bermuda in the past, directly or indirectly (c) when the foreign company directors, its officers, and agents have provided services from Bermuda and (d) when the foreign company needs to be involved in litigation or arbitration in Bermuda.

However, the recognition of a foreign liquidator is subject to the court being satisfied that the appointment of a foreign liquidator is not contrary to the public policy in Bermuda and that it would not prejudice local Bermuda creditors.

GOOD ANSWER, SHORT AND TO THE POINT, BUT COULD HAVE DISCUSSED SOME OF THE COMPLICATING FEATURES ILLUSTRATED BY THE CASE LAW – 6 MARKS

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.

Circumstances a foreign judgment will not be registered or enforced in Bermuda

- A foreign judgment has no “automatic” (direct) legal effect in Bermuda. For it to be enforceable, steps must be taken to enable the foreign judgment to be enforceable in Bermuda. A foreign judgment may be recognised based on (a) statutory rules and (b) common law rules.
- However, there are circumstances in which a foreign court judgment will not be registered or enforced in Bermuda and they include - (a) where the judgment is not covered by the 1958 Act (b) if Bermuda court is of the view that the foreign court had no jurisdiction in relation to the case (c) where the defendant did not receive (sufficient) notice of the proceeding in the foreign jurisdiction to enable him to defend or appear in the proceeding (d) where foreign judgement was obtained by fraud (e) where the foreign judgment is not final and conclusive and (f) foreign judgment relates to taxes and fines (g) where the rule of “natural justice” was not observed and (h) where the recognition of foreign judgment is contrary to Bermuda public policy.

Whether a foreign Court-sanctioned Scheme of Arrangement (“SoA”) might be registered or enforced in Bermuda.

There is uncertainty whether a foreign SoA may be recognised or enforced in Bermuda as a matter of common law.

The court in Bermuda has demonstrated its willingness to recognise a foreign SoA, sanctioned by the foreign court in a non-contentious scheme. It is not certain whether the court in Bermuda will give its recognition or enforcement in Bermuda if it is contentious.

If I may venture to reason on how the court in Bermuda would decide in future - It might not give its recognition or enforcement if the scheme is being contested (for example, the contest relates to Gibbs Rule). This would be consistent with the principle that the recognition of a foreign judgment must be final and conclusive. If the SoA is not contested and that it has been sanctioned and not challenged, the court in Bermuda might recognise the foreign SoA, being a feature that has long existed in the UK Companies Act.

GOOD ANSWER, SHORT AND TO THE POINT, AND APPROPRIATELY DISCURSIVE ON THE TOPIC OF SCHEMES – 7 MARKS

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.

The jurisdictions in which Victory Limited could take to recover cost order against Elbow Limited.

- Victory Limited may consider taking the judgment (cost order) it obtained in Hong Kong and seek registration and enforcement of it in Bermuda against Elbow Limited, being a company in Bermuda.
- In the alternative, Victory Limited may execute judgement against Elbow Limited in Hong Kong.

The defendants against whom Victory Limited could take such action

- The defendant would be Elbow Limited, being a party against whom the cost order was awarded.
- The other (potential) defendants are directors of Elbow Limited (for misfeasance and fraudulent preferences relating to USD 2 million bonus).

- Other (potential) defendants are shareholders (for fraudulent preferences for USD 3 million dividend) if the shareholders had knowledge of insolvency of Elbow Limited.

The pros and cons of litigation as opposed to insolvency proceedings

- If it is a litigation to recover the amount of USD 2 million, the party against whom Victory Limited could sue is confined to Elbow Limited, to recover the sum of USD 2 million.
- If it is an insolvency proceeding, placing Elbow Limited in liquidation, Victory Limited will be forced to share the estate of Elbow Limited with other creditors based on *pari passu* principle.
- It may be that Victory Limited is able to obtain a better financial outcome to recover the USD 2 million, outside of insolvency process (Victory Limited does not have to share its win against Elbow Limited with other creditors).
- Whether Victory Limited will or will not obtain a better financial outcome depends on the financial position of Elbow Limited. On the facts of the case, Elbow Limited has USD 10 million asset. However, it does not indicate the extent of Elbow Limited liabilities. If the net asset of Elbow Limited is USD 10 million, Victory Limited is likely to be able to recover USD 2 million in full, whether it is pursued via litigation or insolvency proceeding.
- The speed of an insolvency proceedings compared to litigation can be a disadvantage. It is likely to take a longer time to recover money through an insolvency proceeding. In an insolvency proceeding, a liquidator will be appointed. He must collect the assets, determine liabilities after a due process, and pay the surplus to the creditors. That normally take time, sometimes a few years as the assets are not liquid.
- The advantage however is that the liquidator may sue the directors to claw back the USD 2 million the directors took on the ground of either misfeasance or fraudulent preference.
- The liquidator may also try to claw back the USD 3 million paid to the shareholders if it could be shown that it was a fraudulent preference.

The causes of action that may be available against the various potential defendants

- Against Elbow Limited – For USD 2 million. To seek recognition and enforcement for the judgment obtained. Various modes of executions may be considered – for example, writ of seizure and sale or garnishee order. In the alternative, Victory Limited may petition to wind up Elbow Limited.
- Against the directors – Victory Limited may sue the directors in their personal capacity for fraudulent trading, for taking the USD 2 million in bonus instead of paying Victory Limited. It may also sue the directors for misfeasance.
- Against the shareholders – If it could be shown that the shareholders were aware of what transpired and that the amount of money was paid to “avoid creditor(s) from being able to get the money”, the shareholders may be held liable.
- Challenge on the validity of the floating charge – A floating charge created within 12 months of the commencement of winding up could be challenged if it could be shown that Elbow Limited was insolvent at the time of creating the charge: s 239 CA 1981. On the

facts, Elbow Limited was cash-flow insolvent at the time it obtained the loan and provided the floating charge. However, the chargee is still entitled to recover the loan given to the extent of the cash given at a statutory rate. From the commercial standpoint, it might not be a good cost-benefit option for Victory Limited.

GOOD 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.

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? Whether it would be more appropriate to take steps before the Hong Kong courts, the Bermuda courts, or both and, if so, why?

- Elbow Limited may restructure its debts in Hong Kong via a scheme or it may restructure its debt in Bermuda via a Scheme of Arrangement.
- There is uncertainty whether a SoA done outside Bermuda will be recognised and enforced in Bermuda.
- It would be better to consider doing a SoA in Bermuda. Bermuda could consider a “soft touch” provisional liquidation. During the provisional liquidation, all legal proceedings against Elbow Limited will be stayed. This gives the directors of the company a “breathing space” to develop a restructuring scheme (SoA) under the supervision of a provisional liquidator. If the restructuring is successful, the liquidation can be terminated.
- It would not be necessary to do a parallel scheme in both Hong Kong and Bermuda. This may be subject to Elbow Limited agreeing not execute the judgement against Elbow Limited in Hong Kong.

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.

- On the basis (assumption) that Elbow Limited has net asset of USD 10 million, and the debt-for-equity swap relates to USD 2 million, it would not fully “extinguish / cancel” the shareholding of the current shareholders. The percentage of shareholding in Elbow Limited (by Victory Limited) depends on the financial position (valuation) of Elbow Limited.
- If Elbow Limited has no liquid asset (cash flow insolvent) but is strong in assets (balance sheet solvent), it may be better for Elbow Limited to consider a debt-for-equity swap, to avoid being placed in insolvency.

- The debt-for-equity swap effectively “extinguishes / cancels” the debt owing to Victory Limited, which can be beneficial for Elbow Limited, resolving its cash-flow solvency issue.
- If Elbow Limited is of the view that its assets are undervalued and the pricing on debt-for-equity swap could not be agreed upon with Victory Limited (due to valuation), Elbow Limited may want to consider raising funds (bank loan or shareholders loan) to pay off Victory Limited.

GOOD ANSWER – 8 MARKS

TOTAL MARKS = 48 MARKS OUT OF 50

*** End of Assessment ***