



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?

A Provisional Liquidator can be appointed under section 170(2) of the Companies Act 1981. The Provisional Liquidator is appointed following the presentation of a winding up petition and its final hearing. The appointment of the provisional liquidator tends to be used in order to avoid assets being dissipated between the final hearing and the petition being presented and the court must be satisfied that the case prima facie has a good chance of concluding that a winding up order is to be made.

Another approach to appoint a Provisional Liquidator is known as a “soft touch” Provisional Liquidator. The Provisional Liquidator is appointed under section 170(3) of the Companies Act 1981, however, their powers are limited to oversight of the incumbent management of the company under Section 170(3). The current company management retain their authority to act on behalf of the company with oversight from the Provisional Liquidators who must approve certain actions as set out in the order. This form of provisional liquidator appointment is commonplace when effecting a restructuring of the company through a scheme of arrangement or other restructuring agreement with its creditors.

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?

The rights of set-off can only be commenced after a liquidation has started in the following circumstances:

- The debts were incurred prior to the Liquidation and have now crystallized as cash liabilities;
- The transaction that incurred the debt was not part of a fraudulent preference or conveyance; or
- The parties dealings were mutual.

GOOD ANSWER – COULD HAVE BEEN BETTER WITH REFERENCE TO LEGISLATIVE PROVISIONS – 1 MARK

Question 2.3 [maximum 4 marks]

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

Security over assets can be given under Bermuda law for assets that are both moveable and immoveable. The following security options are available for immovable property:

Legal Mortgage

The title of the immovable asset transfers to the creditor as security for the debt. The debtor does not retain any legal title but does remain in possession of the asset until such time as they pay off the debt at which point the asset title is reverted back to the debtor.

Fixed Charge

a Fixed charge provides default remedy power under the security allowing the creditor to take control of the asset in order to sell it to repay its debt. The sale proceeds are applied to the secured creditor without recourse to any other creditors.

Movable assets can be secured through several options, set out below is one available option:

Floating charge

A floating charge does not attach to a specific asset, instead it “floats” above several assets such as stock or inventory. These assets tend to go through a significant amount of turnover and therefore it would be unrealistic to require secured creditor approval prior to each sale.

In the event of default by the debtor, the floating charge crystallises and converts into a fixed charge which attaches to the moveable assets remaining at that date.

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.

Bermuda does not have statutory legislation that may grant foreign liquidators recognition, unlike the UK and the US which do have statutory legislation through Section 426 of the UK Insolvency Act and Chapter 15 of the US Bankruptcy Code.

Bermuda does however have common law precedent that allows foreign liquidators to be granted recognition following the Privy Council decision in Cambridge Gas Transportation Corp V Navigator Holdings plc. The precedent has provide the Supreme Court of Bermuda legal argument to rely on in providing recognition to liquidators appointed by the Court of an entity's domicile and the effects of the order made in that domicile. The Supreme Court of Bermuda also has discretion to provide assistance to the foreign liquidator and the foreign proceeding by providing the same level of support that it would have should the proceeding have been a local one rather than a foreign one.

The level of support that the Supreme Court of Bermuda will provide to foreign liquidators has been debated and is subject to the facts of each particular case rather than a standard framework. The Supreme Court of Bermuda is likely to recognise and provide its fullest assistance with matters where there is a sufficient connection between the company in question and the foreign proceeding and foreign courts jurisdiction to make the order in that country.

Other circumstances where the Supreme Court of Bermuda would likely provide its recognition and assistance include the need to be satisfied that documents, assets or liabilities of the foreign entity are held in Bermuda and that the foreign entity has conducted business in Bermuda including maintaining a presence such as a branch and has maintained employees or service providers in Bermuda. Additionally, but not necessarily required is that the entity is involved in legal matters in Bermuda such as litigation.

Additionally, if there is no public policy reason under Bermuda law to the contrary.

The Privy council has tried to ensure that the common law precedent is not developed to far so that it maintains the principle that each recognition granted is based on the facts of the case rather than being granted immediately.

GOOD ANSWER – 8 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.

A judgement or an order of a foreign court does not have a direct legal effect in Bermuda and is not enforceable in Bermuda by itself. The judgement must be recognised before it can be enforced.

Judgements are not automatically recognised, recognition depends on the nature of the foreign judgement rather than having any automatic statutory recognition right.

Foreign judgements can be set aside and not registered if any of the following applies:

- the judgement is not covered by or contravenes the Judgments (Reciprocal Enforcement) Act 1958.
- The foreign court is unable to establish jurisdiction in the circumstances
- The defendant was not sufficiently notified in the foreign proceeding to mount a defence and did not appear
- The judgement was obtained by fraud

Regarding foreign schemes of arrangement there is uncertainty as to whether these can be recognised and enforced without a local parallel scheme being implemented.

The courts have shown willingness to recognise foreign schemes when there is no opposition, however, there is currently no clear indication of what the courts may do where the scheme is contentious.

Where there is a parallel scheme of arrangement in place, there are several high profile examples of the Supreme Court of Bermuda having sanctioned these. However, parallel schemes are not as ideal as a foreign scheme being recognised by the court per the rule in Gibbs.

GOOD ANSWER – 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.

In respect of the actions Victory Limited could take against Elbow Limited and the following questions in the scenario, the following could reasonably apply given the case study.

In question sub question a, Victory Limited would be entitled to enforce its costs award judgement in Bermuda. Whilst the order is made in Hong Kong and Bermuda law does not provide for foreign orders to have direct legal effect, in this scenario a costs order made in Hong Kong would be enforceable as Victory Limited is able to rely on the Judgements (Reciprocal Enforcement) Act 1958 (“the 1958 Act”) as the 1958 Act provides for a procedure whereby judgements rendered in the superior courts of the United Kingdom can be registered in Bermuda and have effect upon registration, these rights have also been extended to the Commonwealth country of Hong Kong under the Judgments Extension Order 1956. Additionally, as Elbow Limited maintains a significant presence in Hong Kong as well as

holding investments in indirect subsidiaries registered in Hong Kong it is likely that the Bermuda courts would be satisfied that the Hong Kong courts had the requisite jurisdiction to make such an order.

Sub question b asks who would be defendants in such actions taken in Bermuda, on the face of the order it would appear that action would only be enforceable against the Hong Kong named defendant being Elbow Limited. However, following receiving recognition of the order, and given the additional facts which had come to light from the disgruntled employee, Victory Limited may be able to take steps to enforce against directors in their personal capacity on the following basis:

Section 246 of the Companies Act sets out that if the directors carry on their business with the intent to defraud their creditors that they may be found personally liable. It could be argued that the directors have continued to trade insolvently as they have been unable to pay a debt as and when it fell due, being to the \$2m cost order provided by the Hong Kong courts. The directors have ignored the order in order to preserve value and continued to trade knowing that this order has been made against the company. Additionally, they have then provided a floating charge security to Lendbank in order to take a \$5m loan over all of their assets, further increasing their insolvent position on a balance sheet basis as they would now be liable for \$7m of claims which would they are unlikely to be able to pay were they to sell all of their assets given the comments that any fire sale would see significant loss of value. Any sums achieved from these sales would be due to the floating charge holder in the first instance leading to a potential preference of a creditor or the misapplication of company property. This has deepened the insolvent nature of the company whilst continuing to trade a further breach of 246. Further, should Elbow Limited enter an insolvency process in short order, it could be argued that this is a breach of Section 245 by inducing lendbank to provide credit to Elbow Limited whilst insolvent and having provided a floating charge security may have further breached this section by placing a charge on its assets and therefore defrauding its current creditor Victory Limited causing the directors to be personally liable. Finally the dividend of \$3m to the shareholders of Elbow Limited may fall under the scope of Section 54 of the Companies Act in which the Company should not declare or pay a dividend in circumstances where the Company would have reasonable grounds for believing it would be insolvent after the dividend payment had been made such as being unable to pay its liabilities including as and when they fall due as set out above, as set out above this is definitely a consideration for Victory Limited.

Sub question c asks what are the pros and cons of litigation versus an insolvency process. Litigation whilst expensive would potentially see a better return to Victory Limited through the potential for costs orders to be made directly by the court that are enforceable in Bermuda and payable to Victory Limited without the need for Victory Limited to participate in an insolvency proceeding where there would be a fire sale of assets diminishing the available value of assets to Victory Limited and further exacerbating the issue as they would rank as a parri passu unsecured creditor and behind Lendbank who would be entitled to their payment first, and given the case study analysis would likely take all funds available from those realizations leaving Victory Limited with nothing. The cons of litigation are that they are expensive and are never 100% certain, Victory Limited could make a good argument for enforcement of the original order and request additional orders against the director as additional defendants, however, these could fail in court leaving Victory Limited to pick up the costs of their own litigation and potential the costs of Elbow Limited. Additionally, if the Company's bye laws provide for full indemnities for the directors in the event of orders being made against them then Victory limited would have to prove fraud and wilful negligence, a high bar in Bermuda and one that has already seen such claims dismissed by the Bermuda court in Peiris v Daniels. If the directors can rely on their indemnities then it may be that the Company enters an insolvency process regardless.

Sub question d asks what are the various causes for action against which defendants. As set out in the considerations of sub question b, the following could be causes for action:

Fraudulent trading under section 246 by virtue of the ongoing trade of the business in full knowledge of a costs order of \$2m which they have been unable to pay as and when it fell due.

Section 245 by taking credit from Lendbank whilst reasonably knowing that the Company may be insolvent, subject to the Company being wound up.

Section 245 by providing a floating charge over the assets of Elbow Limited and therefore prejudicing Victory Limited, subject to the Company being wound up.

Section 54 by paying a \$3m dividend in circumstances where such a dividend would reasonably be believed to place the Company into a position where it is unable to pay its debts as and when they fall due.

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.

Elbow Limited is in a position to restructure its debts via a scheme of arrangement. Schemes of arrangement are open to both creditor and company driven processes, so should the company wish to take this avenue then it is an available option subject to engaging with its creditors and gaining their approval to any proposed restructuring plan.

In this scenario, any scheme should be conducted with a scheme being implemented in Bermuda and either given recognition in Hong Kong or to have a concurrent scheme opened in Hong Kong given that it is where the majority of the business appears to take place. Additionally, any scheme will need to be conducted with a soft touch provisional liquidation process in place given the cost order against the Company from Victory Limited and the potential for further litigation to enforce that cost order in Bermuda. The provisional liquidation would allow for a stay on any current proceedings and provide a moratorium from any future litigation being undertaken. The Provisional Liquidation should also be recognised in Hong Kong to ensure that the moratorium is also implemented there. Elbow should seek to have the scheme and provisional liquidation recognised or concurrently in place in both jurisdictions in order to benefit from the moratorium whilst negotiations continue and also to ensure that any successful restructuring plan can be properly implemented without future challenge or criticism by creditors in one or another jurisdiction were that jurisdiction not included.

The issue Elbow Limited will experience is getting a scheme of arrangement approved by its creditors given the potential for hostility following its treatment of the creditors noted in the case study. In order to bring the creditors on board to approve such a scheme, the Company may need to give further incentive that it was not originally prepared to such as debt for equity swap taking control of the Company away from the current shareholders.

Further issues for Elbow Limited in terms of gaining creditor approval may also be the interplay of classes of creditors and of potentially requiring approval from multiple classes. Given Lendbank is a floating charge creditor and Victory Limited is an unsecured creditor they may be considered to fall in separate classes, therefore making it more difficult for Elbow Limited to implement a scheme, in particular as they will then need to achieve a majority of creditors at 75% of value of total claims voting in favour within each class rather than just overall. It adds a layer of complexity and difficulty as can be seen in the hypothetical example of should Lendbank, holding the largest debt of \$5m, side with the Company's plans together with other smaller creditors they may be able to cram down the scheme on Victory Limited as a dissenting creditor. If they instead fall into groups Victory Limited's vote will hold far more weight and they can demand concessions from Elbow Limited that they might not otherwise have had to give.

Additionally, given the context of the Company and its directors actions that could be considered underhanded would the larger creditors Lendbank and Victory Limited even consider consenting to any debt restructuring plan that did not include an element of handing over control to the creditors to ensure that it is carried out in good faith. As the Company had taken out loans from Lendbank in order to pay dividends and bonuses, this would likely be considered as taking credit on bad faith, particularly given the potential insolvency of the Company as it was unable to pay its debt to Victory Limited as and when it fell due. Further Victory Limited would likely be unhappy that the Company took actions to try to circumvent the costs order from Hong Kong, and then had further deteriorated its financial position including by providing security over assets by floating charge to Lendbank further making recouping of costs more challenging and unlikely.

Therefore, any restructuring plan would likely have a greater chance of success should it include an element of debt for equity swap which would see some control passed from the current shareholders to the creditors, which could allow them to replace the board of directors and put the Company under new management in the future. Given the facts of the case study, it would appear that any debt for equity swap would likely want to see that the majority control of the Company's shareholding would need to pass to the creditors so that they can ensure they have control of the decision making of the Company to avoid similar underhanded tactics in the future. This requirement may be unpalatable to the Company and could result in the Company entering Liquidation with a scheme failing to be implemented.

GOOD ANSWER – 8 MARKS

TOTAL MARKS – 49 MARKS OUT OF 50

*** End of Assessment ***