



## **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 Companies Act 1981, the Supreme Court of Bermuda may appoint a provisional liquidator between the presentation of a winding up petition and its final hearing if there is a good prima facie case that a winding up order will be made and the court considers that the circumstances of the case warrant the appointment of a provisional liquidator. A provisional liquidator may be appointed where there is an urgent need to protect the creditors' interests such as where there is a risk of dissipation of assets in the period between the presentation of the petition and the final hearing. Additionally, a provisional liquidator may be appointed where there is need for independent supervision and control or to assist with a restructuring proposal since the company will benefit from a stay of other legal proceedings upon the appointment of the provisional liquidator.

**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?

Under Bermuda insolvency and bankruptcy laws and particularly guidance from section 37 of the Bankruptcy Act, 1989, rights of set-off can only be exercised after the commencement of a liquidation in the following circumstances:

- (i) the debts giving rise to the set-off have become clear monetary payment liabilities and must have been incurred before the commencement of liquidation
- (ii) the transaction which created the debts was not a fraudulent preference or a fraudulent conveyance; or
- (iii) the parties to the debt are identical to the parties to the credit and the parties have contracted with each other in the same capacity.

**CORRECT – 2 MARKS**

**Question 2.3 [maximum 4 marks]**

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

Under Bermuda law, a creditor may take security over assets in a number of ways including (i) a legal mortgage, (ii) a fixed charge and (iii) a pledge.

In respect of a legal mortgage, the legal title to the debtor's property is transferred to the creditor as security for the debt. The debtor will remain in possession of the property and is entitled to redeem and regain his title upon repayment of the debt whereupon the creditor will reconvey the title to the debtor. A legal mortgage may be taken over immovable, movable and certain intangible property.

A fixed charge may be taken over immovable, movable and certain intangible property. A fixed charge does not result in the transfer of legal or beneficial ownership of the asset as this remains with the debtor, however, the fixed charge enables the creditor to take possession of

the property with a power of sale in the event there is default by the debtor. A debtor is also prevented from dealing with an asset which is subject to a fixed charge without the creditor's consent.

A pledge may be taken over movable and certain intangible property. A pledge enables a creditor to take actual or constructive delivery or possession of the debtor's asset until the debt is repaid or discharged. A pledge also confers upon the creditor a power of sale in the event of default by the debtor.

**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, like many other offshore jurisdictions, have many holding companies with their operating companies being based elsewhere. As a result, in corporate insolvency proceedings, it is not uncommon that there will also be foreign insolvency proceedings which will have an impact on a Bermuda company. This will often require liquidators appointed in the jurisdiction of the operating companies to seek recognition and assistance from the Bermuda Court.

Following the Privy Council decision in *Cambridge Gas Transportation Corp v Navigator Holdings plc*, the Supreme Court of Bermuda has confirmed that pursuant to its common law and not statutory powers, it may have power to grant recognition and assistance to foreign liquidators in Bermuda. The Court has confirmed that it may have power to recognise liquidators appointed by the court of the company's domicile and the effects of a winding up order made by that court, and has a discretion pursuant to such recognition to assist the primary liquidation court by doing whatever it could have done in the case of a domestic insolvency. The use of the phrase "by doing whatever it could have done in the case of a domestic insolvency" was said to have left things unclear and such it was not clear as to the scope of the assistance that the Supreme Court of Bermuda will be prepared to offer to foreign liquidators.

This was recently considered by the Privy Council in the cases of *Singularis Holdings Limited v PricewaterhouseCoopers* and *PricewaterhouseCoopers v Saad Investments Company Limited*. The Privy Council held that the type of assistance to be rendered will depend on the facts of a particular case. However, the Court is likely to recognise the winding up orders of foreign courts and to assist foreign liquidators in circumstances where:

- (i) there is a sufficient connection between the foreign court's jurisdiction and the foreign company making it the most appropriate or the most convenient jurisdiction to have made an order for the winding up of the company and appointment of foreign liquidators;
- (ii) there are documents, assets or liabilities of the foreign company within the jurisdiction of Bermuda; the foreign company has conducted business or operations within, or from, the jurisdiction of Bermuda, whether directly or by agents or by branches; the foreign company has former directors, officer, managers, agents or service providers within the jurisdiction of Bermuda; and/or the foreign company properly needs to be involved in litigation or arbitration within the jurisdiction of Bermuda; and
- (iii) there is no public policy reason under Bermuda law to the contrary.

Additionally, it is important to note that the Privy Council has stated that the Bermuda Court will not grant assistance by exercising a power which it would not ordinarily have been able to exercise over its domestic companies. By way of example, it will only be in a position to make an order for the production of documents to assist the officers of a foreign court of insolvency jurisdiction or equivalent public officers but not to assist in a voluntary winding up. Essentially, the assistance given to foreign liquidators must be consistent with the substantive law and public policy of the assisting court in Bermuda.

### 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.

As a starting point, a judgment of a foreign court has no direct legal effect in Bermuda and is not enforceable in Bermuda until certain steps are taken to have the judgment recognised and enforced in Bermuda. Foreign judgments may be recognised and enforced pursuant to statutory rules or at common law depending on the nature and place of the judgment.

However, the Supreme Court of Bermuda will decline to recognise and enforce a foreign judgment if:

- (i) it does not emanate from one of the courts from one of the jurisdictions designated by the Judgments (Reciprocal Enforcement) Act 1958 and regulations made thereunder;
- (ii) the foreign court had no jurisdiction over the judgment debtor or to grant the judgment or make the order in the circumstances of the case;
- (iii) the defendant in the foreign proceedings was not properly served or did not receive notice of the proceedings in the foreign jurisdiction in sufficient time to enable him to defend the proceedings and did not appear;
- (iv) it was obtained by fraud;
- (v) the rights under the foreign judgment are not vested in the person making the application for recognition and enforcement in Bermuda;
- (vi) the foreign judgment being sought to be enforced is inconsistent with another prior judgment from another court having competent jurisdiction in the matter;
- (vii) the foreign judgment was not final and conclusive in the foreign court;
- (viii) the foreign judgment is for taxes, fines or penalties; or
- (ix) the enforcement of the foreign judgment is contrary to the public policy of Bermuda.

In the event that a foreign judgment has been erroneously registered in Bermuda, on an application by the judgment debtor, the Supreme Court of Bermuda may set aside the registration of the judgment on any of the grounds mentioned above although it is to be noted that in the case of *Masri v Consolidated Contractors International Company* the Court held that it is not entitled to set aside the registration of a foreign judgment on public policy grounds.

In relation to whether a foreign Court-sanctioned Scheme of Arrangement might be registered or enforced in Bermuda, this question is not clear. The Supreme Court of Bermuda has shown some willingness to use its common law power to recognise foreign orders approving foreign schemes in the absence of opposition, it is not clear what the Court's position would be when considering a contested application. It has however been suggested that one workaround may



be that a parallel local scheme of arrangement could be implemented in Bermuda to support the foreign Scheme of Arrangement.

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.

Victory Limited could consider (i) seeking to recognise and enforce its Hong Kong costs order against Elbow Limited in Bermuda and/or (ii) commencing liquidation proceedings against Elbow Limited in Bermuda in order to recover the debt which is owed by virtue of the costs order.

Recognition and enforcement

Victory Limited may seek to recognise and enforce the costs order against Elbow Limited in Bermuda under the common law. A foreign money judgment which includes a costs order, will be recognised and enforced as a debt against the judgment debtor where (i) the judgment is final and conclusive in the foreign court; (ii) the judgment was obtained in a court of law which had jurisdiction over the judgment debtor; (iii) the judgment was not obtained by fraud; (iv) the judgment was not in respect of taxes, fines or penalties; (v) the enforcement of the judgment would not contravene public policy of Bermuda and (vi) the rules of natural justice were observed in the foreign proceedings. On the facts of this case it is likely that Victory Limited will be able to satisfy all the aforementioned requirements in order to have the costs order recognised and enforced in Bermuda. The advantage of recognition and enforcement of the costs order in Bermuda through litigation is that once the costs order is recognised, Victory Limited can then pursue enforcement through any of the methods provided by the rules of court in Bermuda, however, the enforcement mechanism would depend on the assets that Elbow Limited owns.

#### Liquidation proceedings

Victory Limited may also consider commencing liquidation proceedings against Elbow Limited in Bermuda. Pursuant to the Companies Act, a creditor is able to commence liquidation proceedings against a debtor in circumstances including where, the company is unable to pay its debts. A judgment debtor is unable to pay its debts if a judgment in favour of the creditor remains unsatisfied. From the facts of this case it is clear that Elbow Limited has been unable to pay its debt because it has refused to pay the costs order. The advantage of commencing liquidation proceedings is that they are fairly quick and would enable the liquidators of Elbow Limited to drill down the corporate structure and gain control of the subsidiaries in the BVI and Hong Kong so that the liquidators can seek to also realise the assets of those subsidiaries to repay the debt due to Victory Limited if necessary.

Additionally, Victory Limited could consider making an application to the court for the setting aside of the floating charge granted in favour of LendBank as security for the \$5 million loan. Pursuant to section 239 of the Companies Act 1981, a floating charge created on the undertaking or property of a company within 12 months of the commencement of the winding up shall be invalid unless it is proved that the company immediately after the creation of the charge was solvent, except to the amount of any cash paid to the company at the time of, or subsequently to, the creation of the charge, together with interest at the statutory rate. From the facts of this case, it is clear that at the time that Elbow Limited borrowed the loan from LendBank, it was experiencing financial difficulties as it was unable to pay the costs order. Therefore, assuming that Victory Limited brings its application within 12 months of the floating charge being granted by Elbow Limited in favour of LendBank it is likely that it may be able to set aside the floating charge as being invalid. Victory Limited may also consider challenging this transaction on the grounds of it being an unfair preference however this is typically a higher threshold to satisfy.

Furthermore, Victory Limited may consider bringing an action in the Supreme Court of Bermuda to challenge the payment of \$3 million to the directors of Elbow Limited on the grounds of misfeasance and breach of trust owed to Elbow Limited pursuant to section 247 of the Companies Act 1981.

#### 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 may consider entering into a Scheme of Arrangement with its creditors, Victory Limited and LendBank in Bermuda, pursuant to the terms of the Companies Act 1981. 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. A scheme of arrangement may be of benefit to Elbow Limited since it has assets of approximately \$10 million which are illiquid although its debt to Victory Limited is only \$2 million. Where the company faces liquidity issues its freedom to enter into a scheme of arrangement may be susceptible to litigation or compulsory winding up petitions and in such cases, the company may consider entering into provisional liquidation so that there is a moratorium on legal proceedings against the company to afford the company the protection it needs to complete the proposed scheme of arrangement. This often times includes the use of soft touch provisional liquidators.

In order for the scheme of arrangement to be approved, the company must convene a meeting of its creditors. At the meeting of the creditors, the company will need to secure a majority within each class of creditors present and voting at the meeting representing 75% by value of that class, voting in favour of the scheme. The company would then need to seek the court’s approval of the scheme of arrangement which is discretionary, however, provided that the requisite statutory requirements have been met, the court will generally approve the scheme of arrangement.

Additionally, as there are subsidiaries in the BVI and Hong Kong, parallel schemes may also be considered in those jurisdictions to ensure that there is no destabilisation of the group due to the provisional liquidation of the parent Bermuda company while it goes through the process of the proposed scheme of arrangement.

Schemes of arrangement may also be used to reorganise the company’s capital and may also be used to implement a debt-for-equity swap and the court has jurisdiction to make specific provision for this in the order sanctioning the scheme of arrangement. It would be worth Elbow Limited considering whether it would want to include a debt for equity swap option as part of its scheme of arrangement, however, this is often times not used in circumstances where the shareholders of the company intend or want to retain full control of the company. In the present circumstances, it may not be in the best interests of the shareholders to enter into a debt for equity swap arrangement if the company is able to successfully enter into a scheme of arrangement without the need to do so.

GOOD ANSWER – 8 MARKS

TOTAL MARKS = 50 MARKS OUT OF 50

**\* End of Assessment \***