



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?

The Supreme Court of Bermuda appoints a Provisional Liquidator over an insolvent company. Bermuda's legislation is drafted in favour of a pro-creditor approach. However, the appointment of provisional liquidators show that in practice, Bermuda facilitates restructuring plans in favour of the debtor.

Insolvent liquidation procedures in Bermuda are either compulsory liquidations or creditor's voluntary liquidations. Voluntary proceedings are initiated by the company's shareholders through a resolution. However, the supervision of the court is only secured through the petition for a compulsory liquidation.

Upon the petition to the Supreme Court of Bermuda and upon completion of the final hearing, the Supreme Court will appoint a provisional liquidator. The petition can be brought forward by usually a creditor, contributory, the company itself, or the Bermuda Monetary Authority. A provisional liquidator can also be appointed between the presentation of the winding up petition and its final hearing in certain circumstances. This occurs mostly when the assets are at risk of dissipation.

A company may be compulsory wound up for a number of reasons which leads to the appointment of a provisional liquidator. Such examples are:

- The company is unable to pay its debts.
- Resolution for winding up is passed.
- Company engages in restricted or prohibited activity.
- If the court is of the opinion that it is just and equitable to wind up the company.

GOOD ANSWER, BUT COULD ALSO HAVE ADDRESSED PROVISIONAL LIQUIDATION FOR RESTRUCTURING PURPOSES IN MORE DETAIL – 3 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 it comes to creditor rights, claims and security over assets, set offs must be considered. When there are mutual dealings between the debtor company in compulsory liquidation and the creditor, the court will consider what is due from the one party to the other and any sum from one party will be set-off against any sum due from the other party.

Set-off can only be exercised after the commencement of a liquidation of a Bermuda company if:

- The transaction giving rise to the debts was not a fraudulent preference or conveyance.
- The dealing between both parties were mutual.

GOOD ANSWER, BUT COULD HAVE REFERRED TO THE PRECISE LEGISLATIVE PROVISIONS – 1 MARK

Question 2.3 [maximum 4 marks]

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

A creditor may take security over assets under Bermuda law as follows:

- Fixed charge

A fixed charge over property will give the creditor the right to take possession of the property with a right of sale, in the event of default by the debtor. Fixed charge holders are the first paid class of creditors in a liquidation. The debtor and administrator cannot deal with a fixed charge asset without the consent of the secured fixed charge holder. They are then usually paid outside any formal insolvency from the realization of the fixed charge. This is why it is seen as a safer security than a floating charge. A debenture will set out whether the charge is fixed or floating. Fixed charges are commonly used on substantial and physical assets.

- Floating charge

A floating charge is not fixed to any particular asset but floats above a variety of assets. The company debtor may continue to use any asset which has a floating charge without the consent of the of the holder, until the charge crystallizes. Examples of floating charge assets include stock, inventory, and receivables. Floating charge holders are given the power to appoint an administrator to take charge of these assets. There is a prescribed part where a specific monetary amount is set aside for the benefit of the unsecured creditors out of the floating charge realizations; it ranks above, and is paid out before, the balance of the floating charge recoveries. This is put in so that floating charge holders cannot just take everything away from unsecured creditors.

- Legal mortgage

The legal title of the debtor's property is transferred to the creditor as security for a debt. While the debtor remains in possession of this property, they will only be granted legal title upon the payment and satisfaction of the debt and reconveyance of legal title by the creditor. The provisional liquidator should establish clear ownership title when dealing with assets. The liquidator cannot realize an asset on behalf of a debtor for an asset that the debtor does not legally own. The liquidator should therefore perform due diligence on the asset and ensure they have the appropriate legal documentation before any realization of assets.

GOOD ANSWER – 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 should be noted that Bermuda has not enacted the UNCITRAL Model on Cross-Border Insolvency. Recognition and assistance of foreign liquidators in Bermuda therefore takes place under common law powers. There have also been a number of successful applications of Chapter 15 of the US Bankruptcy Code in Bermuda.

The foreign liquidator should note the Practice Directions that the Supreme Court of Bermuda has issued in regard to communication and co-operation between courts. The safest way for a foreign liquidator to implement a foreign court restructuring of a Bermuda company in Bermuda is through a parallel scheme of arrangement.

The foreign liquidator may face the following issues in Bermuda.

- The Supreme Court of Bermuda has no jurisdiction to wind up overseas companies that have not been granted a permit by the Minister of Finance to carry on business in Bermuda. (*PwicewaterhouseCoopers v Saad Investments Company Limited*).
- There is also no US Chapter 15 equivalent currently in Bermuda.
- The Supreme Court of Bermuda cannot order the convening of meetings of creditors.

Foreign liquidators will usually be granted recognition and assistance in Bermuda when:

- There is a sufficient connection between the foreign court's jurisdiction and the foreign company.
- The assets or liabilities of the foreign company are within Bermuda jurisdiction.
- There is no public policy reason under Bermuda law to the contrary.

However, the Bermuda Supreme court cannot assist the foreign liquidator to do something which the foreign liquidator could not do under the foreign law in which they were appointed.

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 foreign judgement has no legal direct effect in Bermuda and is not enforceable. In order for a foreign judgement to be recognized in Bermuda, the foreign liquidator must take certain steps. The foreign judgement may be recognized if the statutory or common law rules are applicable to the judgement.

These may include statutory rules under the Judgements Act 1958 or the Maintenance Orders Act 1974. Common law rules can also be applicable with regard to final money judgements of foreign courts.

The Supreme Court of Bermuda, however, has the power to set aside the registration of a foreign judgement. A foreign Court judgement will not be enforced in Bermuda when:

- The judgement is not covered by the 1958 Act.
- The foreign court has no jurisdiction in the circumstances of the case.
- Fraud is involved.
- Defendant in the foreign jurisdiction did not receive sufficient notice of the proceeding.

The foreign liquidator should be aware that under the Judgements Rules 1976, the Supreme Court cannot set aside the recognition of a foreign judgement just because it is not 'just or convenient' to enforce this judgement in Bermuda. (*Masri v Consolidated Contractors International Company*).

If the foreign judgement cannot be registered under the 1958 Act, then it must be enforced through common law. The Bermuda courts will follow the principles of the common law of England when recognizing foreign judgments. A foreign money judgement will not be recognized under common law when:

- The judgement is not final in the foreign court.
- The judgement was obtained by fraud.
- The judgement was in respect of taxes, fines, or penalties.
- The judgment contravenes Bermuda public policy.
- The judgment was not obtained in a court of law which has jurisdiction over the debtor.

The Supreme Court of Bermuda has shown willingness to recognize foreign Court sanctioned scheme of arrangements. There is, however, uncertainty around whether this can be enforced in Bermuda at common law and there is no guarantee that the Supreme Court of Bermuda will recognize such scheme.

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.

The Hong Kong Court has awarded a cost order against Elbow Limited in favour of Victory Limited in the sum of USD 2 million, payable in full within 14 days. The directors of Elbow Limited have decided not to satisfy this court order.

As the cost award was recognized under Hong Kong jurisdiction, Victory Limited will look to ensure that they take the necessary steps to ensure that this 'foreign judgement' is recognized in Bermuda.

If this cost award falls under the Judgements (Reciprocal Enforcement) Act 1958, the Bermuda Supreme Court will recognize this cost order. The Hong Kong court where the judgment was registered must be one of the superior courts of Hong Kong. As long as Victory Limited can show the following, the foreign money judgement will be recognized and enforced in Bermuda:

- The Hong Kong judgement is final.
- The Hong Kong court had jurisdiction over Victory Limited and Elbow Limited.
- The judgment was not obtained by fraud.
- The judgment was not in respect of taxes, fines, or penalties.
- The judgment does not contravene the public policy of Bermuda.

Victory Limited will certainly want to investigate the actions of the directors of Elbow Limited and look to bring an action against the directors. The directors borrowed \$5M to pay themselves a bonus and also their shareholders. The Companies Act 1981 provides that Elbow Limited can only return capital to its shareholders by way of an authorised dividend. There is reasonable ground to argue that Elbow Limited would also not be able to pay its debts, such as the cost order, and therefore is now allowed to declare a dividend under Section 54 of the Companies Act. It could also be argued that the directors are in breach of duty to exercise reasonable skill and care. They have taken out a loan to pay themselves a bonus and may be held personally liable for not acting in good faith here. Victory Limited will want to ensure that these payments made by Elbow are overturned so they can claim their cost award.

Victory Limited can look to do this through two options:

- Petition for the cost award to be granted and if not paid, Elbow Limited to be wound up. If the award is not paid, the cost of proceedings should be considered as these can be high. Under insolvency proceedings, it may take longer for Victory Limited to receive any cost award. Their priority rank and the fact that Elbow Limited will need to appropriately value and realize assets before distributions to creditors may result in a slower process.
- Appoint an insolvency litigation lawyer to bring a claim against Elbow Limited. They would investigate the specific transactions the directors made and will look to hold them liable for these potential fraudulent transactions. This however would be costly and time consuming as opposed to bringing a proceeding for the claim.

Another option would be parallel proceedings but Victory Limited is not a secured creditor. It should be noted that Bermuda has not enacted UNCITRAL as Elbow Limited has an establishment in Hong Kong. If a winding up order is brought against Elbow Limited, Victory Limited may not be able to continue with its execution of its judgement against the company.

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 can restructure its debt obligations through a Scheme of Arrangement under the Companies Act 1981. This aims to reorganize the business of the debtor with a view to continue trading. Elbow Limited should initiate this application to the Bermuda Supreme Court. A creditor or member may also bring this application forward. This will be effective once the order is delivered to the Registrar of Companies.

This scheme will look to adjust or compromise the two main debts that Elbow Limited are facing: the cost order from Victory Limited and the \$5M bank loan. The scheme could include transferring the rights, property, and liabilities of Elbow Limited to another company.

It should be noted that a majority of each class of creditors present and voting, representing 75% or more in value, must vote in favour in order for this Scheme to be binding. As Victory Limited are a dissenting creditor, Elbow Limited could seek the Bermuda’s court approval to cram-down this creditor. This will be difficult to achieve however if the Hong Kong judgement is enforced in Bermuda.

It could be argued that the Scheme of Arrangement should be under the control of a liquidator and not the directors. This is due to the breach of duty displayed by the directors in their bonus and share distributions.

Elbow Limited could also consider a petition to the Supreme Court of Bermuda for a winding up of the company. They could then apply for a statutory stay of all proceedings against the company. If the work out negotiations are then successful, the winding up order can be dismissed.

A debt for equity swap may also be considered in Schemes of Arrangements. The creditors are likely to reject this idea. The bank already holds a floating charge against all the shares of the company. If Victory Limited can enforce the Hong Kong judgment, they are more likely to receive funds. Also, the creditors would need to perform a valuation of the company and be cautious of the directors’ breaches in duty. Shares in this company is also not an attractive option. The company is insolvent and they have just paid a dividend which Victory Limited will look to claw back.

Elbow Limited can also consider the use of parallel schemes of arrangement, sanctioned by the Bermuda court and the Hong Kong court. Issues to be considered here however would be the ability of the Supreme Court of Bermuda to wind up the oversea companies in Hong Kong.

The Supreme Court of Bermuda also lacks jurisdiction to order the convening of creditors in relation to debt arrangements.

GOOD ANSWER, ALTHOUGH SOME ASPECTS OF THE RESPONSE, SUCH AS THE FINAL PARAGRAPH, SUFFERED FROM A LACK OF CLARITY – 6 MARKS

TOTAL MARKS = 46 MARKS OUT OF 50

*** End of Assessment ***