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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.

INCORRECT

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 is appointed at the period in time between where the final hearing has not yet been heard but the winding up petition had been presented to the Court.

This can be done on an urgent basis also to avoid the risk of assets being transferred out of the jurisdiction or become untraceable to the liquidators, before they are appointed as the official liquidators.

The provisional liquidator may also apply for a stay of all proceedings against the Company to enable discussions surrounding a scheme of arrangement. This would be referred to as “soft-touch” provisional liquidation. The directors of the Company are normally tasked with managing the scheme with the supervision of the provisional liquidator.

THIS IS BROADLY CORRECT, ALTHOUGH THE STAY IS NOT ORDINARILY SOUGHT BY THE PLs, BUT BY THE APPLICANT FOR THEIR APPOINTMENT – 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?

Rights can be set-off in the following circumstances:

- If there were any debts prior to the commencement of the liquidation which have transformed to monetary liabilities that led to the associated set-off.
- If transactions forming the debt were not a fraudulent preference or fraudulent conveyance.
- If the parties that were responsible for the debt were identical to the parties who have benefited from the debt.

CORRECT – BUT COULD BENEFIT FROM CITATION TO THE STATUTORY PROVISION – 1 MARK

Question 2.3 [maximum 4 marks]

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

There are many ways to take security over assets under Bermuda Law, which is done by an agreement between the creditor and the debtor.

The statutory provision that governs security over assets are Section 19(d) of the Supreme Court Act 1905, Section 1 of the Bonds and Promissory Notes Act 1874 and Section 2 of the Charge and Security (special Provisions) Act 1990.

The following are three ways of taking security over assets under Bermuda law

1. Mortgage – This type of security can either be in the form of legal or equitable mortgage and is in respect to immovable, movable and certain intangible property. A legal mortgage includes the transferring of the debtor’s asset to the creditor as security for a debt. The asset remains in the possession of the debtor, however legal title can only be regained upon payment of the debt. An equitable mortgage includes the transferring of the beneficial interest only to the creditor. The debtor remains in possession of the legal title.

2. Fixed Charge – This type of security can also either be in the form of legal or equitable mortgage and is in respect to immovable, movable and certain intangible property. Fixed Charges does not result in the transfer of legal title or beneficial ownership from the debtor to the creditor. It does however allow for the creditor to take possession of the asset with the authority to sell, if the debtor defaults and the debtor is also not allowed to handle business in relation to the asset without the consent of the creditor. The proceeds of the sale can then be applied by the creditor in priority ranking.
3. Floating Charge – This type of security can either be in the movable (including certain intangible properties). Floating charges are not fixed to a particular asset, it is said to “float” over a group of assets. With this type of security, the debtor has the right to sell or dispose of it without the consent of the creditor. If the debtor defaults, the floating charge is said to then crystallise and will convert into a fixed charge over a specific assets.

CORRECT – 4 MARKS

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

Question 3.1 [maximum 8 marks]

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

A foreign liquidator is an individual appointed in a different jurisdiction other than the home country, who is seeking to be recognised in the home country to undertake insolvency duties. There is no statutory Bermudian legislation or rules that govern the process of granting recognition and assistance to foreign liquidators in Bermuda, this is covered under common law. Bermuda has also not adopted the UNCITRAL Model Law on Cross Border Insolvency.

There are two landmark privy counsel decisions in Bermuda which engaged the debate to allow for the rules granting common law recognition to be clarified. Those decisions derived from the cases Pricewaterhousecoopers vs Saad Investments Company Limited (2015) and Pricewaterhousecoopers vs Singular Holdings Limited. Pursuant to these two landmark cases, Bermuda Court is likely to assist foreign liquidators in the following circumstances.

- 1) If the Company is incorporated in Bermuda
- 2) If there is a connection between the foreign courts’ jurisdiction and the foreign company and if it has been deemed that Bermuda is the appropriate jurisdiction for a winding up order to be made.
- 3) If there are physical assets, documents and liabilities that can be known and locatable in Bermuda on behalf of the Company
- 4) Once the recognition does not go against the Bermuda public policy (and remain bias towards Bermudian creditors).

However, the specific facts of the case law will have to be considered and if the above are not satisfied, the recognition can be declined/rejected. Also, foreign recognitions are not granted to assist the officers of a foreign court of insolvency jurisdiction. For example, in the case of Stephen John Hunt v Transworld Payment Solutions UK Limited, the Bermuda Court declined to recognise the foreign appointment as it was determined that the Company did not have any assets in Bermuda and therefore the recognition did not serve a legitimate purpose. Bermuda however does provide assistance specifically to courts in the United Kingdom. However, in relation to Foreign Scheme of Arrangements, there is still some uncertainty as to whether these can be recognised and enforced in Bermuda under common law.

GOOD ANSWER, BUT WOULD HAVE BEEN BETTER TO REFER TO THE PRIVY COUNCIL WITH ITS CORRECT SPELLING – 7 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.

Foreign Court judgements can be recognised or enforceable in Bermuda pursuant to specific statutory rules or common law rules. There are however additional statutory or common law rules application to various other orders in Bermuda. As stated in the guidance text these rules apply to foreign arbitration awards, foreign judgements relating to the administration of estates, foreign decrees of dissolution or nullity of marriage, foreign maintenance orders, as well as rules relating to foreign bankruptcy proceedings.

However, steps have to be taken for a foreign Court judgement to be legally enforced in Bermuda. The following instances include the instances when foreign judgements would not be enforced.

- 1) If it is not covered by the Judgements (Reciprocal Enforcement) Act 1958
- 2) If the judgment was registered in the contravention of the Judgements (Reciprocal Enforcement) Act 1958
- 3) If the foreign court had no jurisdiction in the circumstances of the case
- 4) If the defendant did not receive notice of the proceedings in foreign jurisdiction in sufficient time to allow him to defend the proceedings
- 5) If the judgement was obtained fraudulently
- 6) If the rights under the judgment was not vested in the person by who the application for registration was made

A foreign judgment which does not fall within the 1958 Act can be enforced in Bermuda under common law. Formal pleadings must be filed in the Supreme Court. The recognition for those judgments is quite different to that of a foreign judgement. Foreign money judgments will be recognised and enforced in the following instances:

- If the judgment is final and conclusive in foreign courts
- If the judgment was obtained in court of law who had jurisdiction over the debtor
- If the judgment was not obtained by fraud
- If the enforcement of the judgment would not contradict the public policy of Bermuda
- If the rules of nature justice were observed in the foreign proceedings.

Foreign scheme of arrangements can be registered and enforced in Bermuda. This can be done by a parallel scheme of arrangement, which is where the Bermuda Court recognises schemes that link Bermuda and the United Kingdom, Singapore or Hong Kong. However, there has been concerns over whether foreign scheme of arrangements can be recognised and enforced under common law.

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.

There are various options that Victory Limited can take to recover the costs order against Elbow Limited. Firstly, Victory Limited can obtain sanction for recognition of their foreign judgment in Bermuda for the costs order that was made by the Hong Kong court against Elbow Limited in favour of Victory Limited. It is not secret that the directors of Elbow Limited chose not to enforce the judgement that was handed down by the Hong Kong courts all because they did not want to "destroy the value of the illiquid assets". Victory Limited can also sue Elbow Limited in the Hong Kong courts for ignoring the previous costs order. However, Elbow Limited may ignore these proceedings again. However, the order is not just enforceable as it stands, certain statutory and common law criteria should be met based on the jurisdiction for judgments to be recognised and enforced and based on the facts of the case, Victory Ltd can look to recover its costs.

The defendants that Victory Limited can rightfully take action against are the Company, Elbow Limited and/or the directors of the Company can be held personally liable. The directors did not act with due care towards the Company, as they ignored a costs award in favour of one of its subsidiaries who assisted with funding for the Company, then led to take out a loan for 5 million of which the directors received a portion as a bonus payment and declared a dividend to shareholders whilst the Company still had liabilities unpaid. The directors should be made to repay the 2 million in bonus they received and held liable for the payment made to shareholders. The guidance text refers to unauthorised payments made to shareholders in that According to Section 54 of the Companies Act, the Company shall not declare a dividend,

or make a distribution if there is reasonable grounds for believing the company would be unable to pay its liabilities as they become due.

The biggest issue with opening insolvency proceedings, is the ultimate winding up of the company once the assets have all been realised and distributed. Elbow Limited does not have to be liquidated in order for Victory Limited to receive the monies owed to them. Elbow Limited has assets that are thriving (regardless of its illiquidity). Litigation will be a better option for the future of Elbow Limited, if the directors are ordered to repay the 2million dollar bonus they received which would be just enough to cover the costs owed to Elbow (not considering any interest that may be added), by way of unlawful return of capital. Elbow Limited does not have to be in liquidation to adhere to this as per Section 54 of the Companies Act 1981 Elbow Limited should not have made the payments to the directors if after the payments, they would have been unable to settle their liabilities.

A second point is that it may be hard to open proceedings over Elbow as they are not “unable to pay their debts”, they simply chose to ignore the order, however due to the lack of honesty by the directors, the judge may allow it. And also opening Insolvency proceedings may also be more costly than litigation proceedings. Opening Insolvency Proceedings will also allow for claims against the directors to also be pursued and the assets can be realised to pay off the creditors.

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 take steps to restructure its debt in the form of a Scheme of Arrangement, which can either be initiated by a creditor, a member of the Company. This is a formal procedure that is used to reorganise the business of a debtor with a view of continuing to trade and this includes all the debt of Elbow Limited.

In the case of Elbow Ltd, there are illiquidity matters that arise and as a result the courts may be keen to appoint a “soft touch: provisional liquidator to be able to apply a certain degree of protection on the scheme.

For a Scheme of Arrangement to be approved, it requires the approval of majority of the creditors being present and voting (whether by proxy or in person) and representing 75% by value of that class. The arrangement can be conducted in the Bermuda courts once the foreign judgment for the debt owed to Victory Limited is recognised and enforced as Elbow Limited is an exempt company incorporated in Bermuda. However, there have previously been a number of cases where there are connections to certain jurisdictions, a parallel scheme of arrangement can occur. Therefore, steps can be taken in both Bermuda and Hong Kong, however this would have to be sanctioned by them both courts so that they are working towards the same goal and not duplicating procedures. Elbow Ltd carries out business in both jurisdictions, and so there will be creditors located in both jurisdictions. With both jurisdictions opening proceedings, matters in both jurisdictions are sure to be covered especially with the costs order being made in Hong Kong.

A debt-to-equity swap can be implemented as a way to reorganise the Company’s capital. It is an arrangement where the company converts its debt into stock. It is proposed that the creditors of Elbow Limited be issued new shares in exchange for their debt in the company and existing shareholder debt be cancelled. This would only have been proposed in the case of a financial crisis, and Elbow Limited is currently at that point. With engaging in a

debt-to-equity swap, Elbow Limited can avoid being wound up by its creditors and the Company can continue to trade and Elbow Limited would have been saved from making immediate cash flow repayments and will be able to maintain their cash flow. However, with shareholders losing their existing shares in the Company, and the additional shares that would be granted by the Company, Elbow Limited may struggle with diluted control of the Company and not all creditors and shareholders may be willing to accept the terms proposed in the debt to equity swap which may lead to additional issues.

GOOD ANSWER – BUT SOME CONFUSION AS TO THE ROLE OF A MEMBER IN THE CASE OF A CREDITOR SCHEME – 6 MARKS

TOTAL MARKS – 43 OUT OF 50

*** End of Assessment ***