INSOL INTERNATIONAL

FOUNDATION CERTIFICATE

IN INTERNATIONAL INSOLVENCY LAW

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**.

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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 be a Provisional Liquidator be appointed?

Provisional "soft-touch" liquidation is a formal restructuring process in Bermuda. A provisional liquidator may be appointed with specific powers to implement a restructuring that have credible prospects of success and the support of the majority of creditors. These prospects may be formal or informal restructuring plans.

A provisional liquidator can be appointed prior to the final hearing of a compulsory winding up petition if it is likely that a winding up order will be made and if the Court considers that a provisional liquidator should be appointed in all the circumstances of the case. This is the case where there is a risk of dissipation of assets, or the need for independent supervision and control.

Section 23 of the Companies (Winding Up) Rules 1972 states that the Supreme Court of Bermuda ("**Bermuda Court**") shall appoint a provisional liquidator once presentation of a petition is made for the winding up of a company by the Court, upon application by a creditor, or a contributory, or the company, and upon proof of affidavit of sufficient ground for the appointment of a provisional liquidator, and the Court thinks it is just and necessary for such appointment.

For the best interest of the creditors, the court may appoint a provisional liquidator if there is a risk that assets will be dissipated in the period between presentation of petition and the final hearing, or in the event that that a restructuring is capable of being achieved under the supervision of an independent Court officer and with the benefit of a stay of other legal proceedings. In these situations, the Court is allowed to appoint a provisional liquidator under section 170(2) of the Companies Act 1981 ("1981 Act").

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?

Section 37 of the Bankruptcy Act 1989 states that where there have been mutual credits, mutual debts or other mutual dealings, between a debtor against whom a receiving order shall be made under this Act and any other person proving or claiming to prove a debt under the receiving order, an account shall be taken of what is due from the one party to the other in respect of the mutual dealings, and the sum due from the one party shall be set off against any sum due from the other party, and the balance of the account, and no more, shall be claimed or paid on either side respectively; but a person is not entitled under this section to claim the benefit of any set-off against the property of a debtor in any case where he had, at the time of giving credit to the debtor, notice of an act of bankruptcy committed by the debtor and available against him.

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

- The debts giving rise to the set-off were incurred prior to the commencement of liquidation and have crystallized as monetary payment liabilities;

- The transaction giving rise to the debts was not a fraudulent preference or a fraudulent conveyance; or
- The dealings between the parties were mutual (that is, the parties giving rise to the debts are identical to the parties giving rise to the credit and the parties have contracted with each other in the same capacity).

GOOD ANSWER – 2 MARKS

Question 2.3 [maximum 4 marks]

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

Similar to jurisdictions that follow English common law, there are a number of ways that a creditor can take security over assets in Bermuda by agreement between the creditor and the debtor. The taking of security in Bermuda is provided under 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.

In respect of immovable, movable and certain intangible property, a creditor may take, and a debtor may give, security as legal mortgage, equitable mortgage or fixed charge.

- Fixed charge: when a debtor defaults on a loan or a debt, a creditor can take a fixed charge over property that does not result in a transfer of legal or beneficial ownership but gives the creditor a right to take possession of the property with a right of sale. Once the creditor exercises its power of sale, the proceeds of sale may be applied by the creditor towards payment of the debt in priority to and without reference to other unsecured creditors. The debtor will require prior consent from fixed charge creditors to deal with fixed charge properties.

In respect of movable and certain intangible property, a creditor can additionally take, and a debtor may give, security as floating charge, pledge or lien.

- Floating charge: Unlike to a fixed charge, a floating charge is not fixed to a particular property. The debtor can deal with the property without prior consent from floating charge creditors, but in the event of default by the debtor, the floating charge will crystallise and convert into a fixed charge that attaches to specific properties remaining at that date.

A creditor may also take, and a creditor may give, security through assignment.

- Section 19(d) of the Supreme Act 1905 provides that an absolute assignment in writing of any debt or other legal chose in action is deemed effective in law, where notice is given to the debtor or other contracting party. Where these requirements are met, the assignee may sue in its own name.
- Section 1 of the Bonds and Promissory Notes Act 1874 authorizes the assignment of bonds ad other debt instruments, and empowers the assignee to bring an action in the name of the assignee against the debtor under the instrument.

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.

Bermuda has no statutory equivalent of chapter 15 of the US Bankruptcy court, section 426 of the UK Insolvency Act 1986 or Cross Border Insolvency Regulations 2006 (also in the UK). In a Supreme Court of Bermuda (the "Supreme Court") case Cambridge Gas Transportation Corp v Navigator Holdings plc, the Privy Council made a decision that as a matter of common law, the Supreme Court of Bermuda ("Bermuda Court") may recognise liquidators appointed by the court of the company's domicile and the effects of a winding up order made by the 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 Court does not have a power to assist foreign liquidators to do something which they could not do under the law by which they were appointed, and the Court's exercise of its power must be consistent with the substantive law and public policy of the assisting court in Bermuda. An example of this is the case of *Stephen John Hunt v Transworld Payment Solutions UK Limited* whereby the Bermuda Court did not recognise the appointment of a UK liquidator where no active assistance had yet been requested.

Recently, the notion of "doing whatever is could have done in the case of a domestic insolvency" has been debated with recent judgments by the Privy Council on appeals from the Court of Appeal for Bermuda.

Some of the notable cases where the above is applied are *PricewaterhouseCoopers v Saad Investments Company Limited* ("SICL case") and *Singularis Holdings Limited v PricewaterhouseCoopers* ("SHL case").

Both the SICL case and the SHL case appeals is related to foreign liquidators' attempts to obtain material, principally the working papers belonging to PwC, by seeking approval from the Bermuda Court to be granted power under section 195 of the 1981 Act which provides power to summon persons suspected of having property of company.

The power of the Bermuda court under section 195 can only be exercised in respect of a company which the Bermuda court has ordered to be wound up, in this case a power to wind up a company incorporated outside Bermuda. In the SICL case, the Bermuda Court made a winding up order, and then made an order for production and oral examination against PwC in the winding up. In the SICL appeal, the Board has advised Her Majesty that the winding up order must be stayed because the Bermuda court had no jurisdiction to wind up a company incorporated outside Bermuda. The consequence is that all proceedings in the winding up of SICL have ceased to be effective, including the order made under section 195.

The Bermuda Court currently 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.

In the SHL case, a different procedure was adopted. No winding up order was ever sought or made in Bermuda. Instead, an order was made recognising in Bermuda the status of the Liquidators by virtue of their appointment by the Grand Court of the Cayman Islands and exercising a common law power "by analogy with the statutory powers contained in section 195 of the Companies Act" to order PwC and Paul Suddaby ("Mr Suddaby"), an officer of PwC, to produce the same documents which they could have been ordered to produce under section 195. PwC were also ordered to have a partner, employee or agent acceptable to the liquidators available to answer oral or written interrogatories. The liquidators were given leave to serve the proceedings on Mr Suddaby and any other "partners or officers" of PwC out of the jurisdiction.

The Bermuda Court is likely to recognise winding-up orders issued by foreign courts to assist foreign liquidators in circumstances where:

i. There is "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, officers, 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 Bermudian law to the contrary (if, for example, there would be unfairness or prejudice to local Bermudian creditors)

The Privy Council noted that where a foreign liquidator makes an application for an order for production of document by an entity within Bermuda, the power is only available only where necessary to assist the officers of a foreign court of insolvency jurisdiction or equivalent public officers, but not available to assist a voluntary winding-up (private arrangement).

GOOD ANSWER, BUT A FEW GRAMMATICAL MISTAKES MADE SOME PARAGRAPHS HARD TO FOLLOW – 6 MARKS

Question 3.2 [maximum 7 marks]

Write a brief essay on the circumstances in which a foreign Court judgment **will not be** registered or enforced in Bermuda. Also consider and address the question as to whether a foreign Court-sanctioned Scheme of Arrangement might be registered or enforced in Bermuda.

A judgment or order of a foreign court ("**a foreign judgment**") has no direct legal effect in Bermuda. A foreign judgment is not enforceable in Bermuda in and of itself. Steps have to be taken to have a foreign judgment legally enforced in Bermuda.

In the case of final money judgments of superior courts in the UK and certain Commonwealth countries and territories, there are statutory rules that apply to their registration and enforcement in Bermuda. The conditions are contained under section 2 of the Judgment (Reciprocal Enforcement) Act 1958 (the "1958 Act"). As such, foreign judgment will not be registered or enforced in Bermuda if:

- The judgment is not final and conclusive notwithstanding that an appeal may be pending against it or that it may be subject to appeal, in the UK; and
- A sum of money is payable under the judgment and the judgment is in respect of taxes, fines or other penalties.

Section 7 of the 1958 Act contains further conditions for the registration of certain foreign judgments; the foreign judgment cannot be registered if:

- A sum of money is not payable under the judgment; or
- The judgment had been wholly and partly satisfied; or
- That at the date of the application the judgment could not be enforced by execution in the UK.

Under basic common law rules, foreign money judgment will not recognized and enforced as a debt against the judgment debtor where:

- The judgment is not final and conclusive in the foreign court;
- The judgment was obtained in a court of law which had no jurisdiction over the judgment debtor;
- The judgment was obtained by fraud
- The judgment was in respect of taxes, fines or penalties;
- Enforcement of the judgment would contravene the public policy of Bermuda; and
- The rules of natural justice was not observed in the foreign proceedings.

In the case of maintenance orders made by foreign courts of reciprocating countries, there are statutory rules that apply to the registration and enforcement governed under section 5 of the Maintenance Orders (Reciprocal Enforcement) Act 1974 (the "1974 Act"). However, section 9 states that registration of order can be cancelled where:

- a registered order is revoked by an order made by the registering court; or
- a registering order is revoked by a provisional order made by that court which has been confirmed by a court in a reciprocating country and notice of the confirmation is received by the registering court; or
- a registered order is revoked by an order made by a court in such a country and notice of the revocation is received by the registering court.

There are some uncertainties whether a foreign scheme of arrangement can be recognised and enforced in Bermuda as a matter of common law, in the absence of a local scheme of arrangement implemented in parallel. This holds true in a number of cases whereby a parallel scheme was implemented in Bermuda and the USA:

- In *Re C&J Energy Services Ltd [2017] BDA LR 22*: this is the case where the company and its affiliates files for Chapter 11 in the US ("foreign proceeding") whereby a parallel proceeding in Bermuda in the form of a soft touch ("provisional") liquidation to assist the foreign proceeding. This provided some breathing space to the debtor (in the form of the automatic stay) without threat of individual (and multiple) threats to litigation;

- In *Re Energy XXI [2016] BDA LR 90*: in a similar scenario whereby a group of companies filed for Chapter 11 in the US ("foreign proceeding"). The court granted the petition to place the company into provisional liquidation (and obtained a stay in proceedings) in parallel of the foreign proceeding. The role of the provisional liquidators is to oversee the restructuring place in the foreign proceeding; and

- *Re Seadrill Limited [2018] BDA LR 39*: the company also petitioned to place the company into provisional liquidation to assist the Chapter 11 proceeding in the US in parallel again to provide breathing space for the debtor in order to focus their attention on the restructuring plan.

To conclude, the Bermudian court will recognize schemes of arrangements so long as there is a parallel proceeding in Bermuda.

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 made a cost order in favour of Victory Limited ("Victory") against Elbow Limited ("Elbow" or the "Company") in the sum of USD 2 million, payable in full within 14 days (the "foreign judgment"). The Company's directors decided not to satisfy the Hong Kong Court judgment as the directors did not consider that the Hong Kong Court judgment would be enforceable against it in Bermuda.

In general, the Bermuda Courts will recognise and enforce a foreign money judgment which falls within the ambit of the Judgment (Reciprocal Enforcement) Act 1958 (the "1958 Act") or the common law rule for recognition and enforcement.

The foreign judgment was made by the Hong Kong Court therefore it is not covered by the 1958 Act therefore Victory must satisfy the Court that the foreign judgment can be enforced and recognized through the common law rule.

Victory satisfies the common law rule therefore the foreign judgment can be recognized and enforced in Bermuda as a debt against Elbow because:

- The foreign judgment is final and conclusive in the foreign court;
- The Hong Kong court has jurisdiction over Elbow as the company has substantial presence in Hong Kong;
- The foreign judgment does not seem to have been obtained by fraud nor was it in respect of taxes, fines or penalties; and
- The enforcement of the judgment would not contravene the public policy of Bermuda.

Victory can either choose to litigate the company or petition the company by placing it into liquidation, however the approach and application of the law contained in the 1981 Act will differ in whichever scenario Victory takes. In general, Victory can go after the directors of the court if they fail to comply with their duties under section 97 of the 1981 Act.

Victory can go after the company's directors through negligence i.e. breach in fiduciary duties and failure to exercise reasonable skill and care.

To the extent that the Company is solvent, directors and officers principally owes duties to the company for the benefit of its present and future shareholders and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (section 97 of the 1981 Act). When a company is deemed or enters into the zone of insolvency, those duties are transferred towards the Company's creditors instead.

At the due date of the payment of the foreign judgment, though Elbow's assets were valued at USD 10 million, the assets are illiquid as it consists of litigation funding loan and distressed debt. The directors did not want to realize these assets to pay the foreign judgment as they are in the opinion that a "fire-sale" would destroy the value of these assets therefore value of would have been significantly less than USD 10 million. Elbow can be deemed "cash flow" insolvent at the due date as it cannot meet its obligation as it falls due therefore, the directors owed duties towards the Elbow's creditors including Victory.

Subsequent to the due date of the foreign judgment, the directors borrowed USD 5 million from a bank secured by a floating charge against Elbow's shares and the assets of Elbow's subsidiaries (unclear whether this is all of its subsidiaries). This loan was utilized to pay the following:

- USD 2 million bonus to the directors
- USD 3 million dividend to the shareholders

Insolvency can also be challenged in a way that the company processing this transaction resulted in a company becoming insolvent.

Failure to comply with fiduciary duties will result in the directors becoming personally liable to a fine of $1,000 (under subsection 6 of section 97 of the 1981 Act).

Section 83 of the 1981 Act states that the company must keep proper records. Failure to do so will result in each director being personally liable to a fine of $500.

There are a number of benefits (and disadvantages) to Victory and extra actions that an appointed insolvency practitioner can take if Victory petitions the company to be placed into liquidation.

An automatic stay is obtained once a company is placed into liquidation and a provisional liquidator is appointed. This can be both beneficial and detriment to Victory. At first instance, separate potential actions that Lendbank or the disgruntled employee might take which will result in some breathing space for the liquidators. The stay will also stop Victory from taking actions themselves against the company.

There are a number of actions that is only available once the company is placed into liquidation.

Fraudulent conveyances (under section 36A to 36G) can be reviewed in the event of the company being placed into liquidation. Fraudulent conveyance refers to the illegal or unfair transfer of property to another party (placing these properties out of reach of creditors in the anticipation of an insolvency proceeding) to defer, hinder or defraud creditors. Both the bonus to directors and dividend to the shareholders can be reviewed in the insolvency process if the transactions happened within 6 months of the appointed day. It is unclear when the transactions occurred as "subsequently" in the case study can mean months or years. In the event that these transactions were processed within the relevant period, either Victory and Lendbank can make this application to the court. This may result in both directors and shareholders to return the money paid out to them.

When it comes to distribution of assets on the conclusion of insolvency, another disadvantage for Victory is their ranking in the claims. The list of ranking below assumes no fixed charge holders exist:

- Firstly, the liquidators (and any specialists/lawyers that assisted in the liquidation process) must be paid first (section 232 of the 1981 Act) regardless of whether all assets are secured through a floating charge.
- Considering, the former employee is disgruntled, this employee may be owed a sum of money and takes next ranking to the distribution of assets (subject to section 236 of the 1981 Act) regardless of whether all assets are secured through a floating charge.
- Floating charge takes next priority. Lendbank's loan to the company was created by way of a floating charge. However, this must be registered with the Registrar for the Lendbank as the floating charge holder to pursue its claim against the floating charges.
- Last if Victory claim on unsatisfied judgment, possibly Lendbank's original loan given to Elbow (assume Lendbank's original loan had no securities as Elbow was able to provide security of the subsequent loan of all of its assets) and other unsecured creditors not mentioned in the case study will be classified as unsecured claim.

If the priority of claim holds, Victory's ability to claim the judgment granted to them is slim in a situation where there are no assets available for distribution after liquidation expenses, preferential creditors and floating charge holders. The only possible distribution that Victory can participate in is from any realisation of assets from assets not held in subsidiaries but will have to be received pari passu with Lendbank's unsatisfied floating charge amount (if not completely paid), and original loan, and other unsecured creditors of Elbow.

Floating charge can be invalid under section 239 of the 1981 Act unless it can prove that the company became solvent within the 12 months of the commencement of the liquidation. Considering that the value of the assets is $10m, this is still questionable as these are risky assets. If the liquidator fails to conclude that this creation of floating charge made the company solvent, then the assets made under the floating charge will be included in the general estate of the company and will be distributed pari passu to Lendbank, Victory and other unsecured creditors.

GOOD, THOROUGH 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.

The only formal restructuring procedure (outside of "soft touch" liquidation) in Bermuda is a scheme of arrangement. This will allow the debtor to reorganise the business of the debtor, adjust the debt of creditors and reduce the capital of shareholders while the business is able to continue trade. The overall goal is for the company to be able to continue its business in the long run.

A scheme would require approval from majority of within each class of creditors at the meeting of each class. In the case study, the only known creditors of Elbow are as follows:

- Lendbank: a floating charge creditor that is owed $5m secured by all shares and assets in its subsidiaries; and
- Victory (non-secured creditor), Lendbank (non-secured creditors) and other non-secured creditors that may exist.

Elbow will be required to obtain approval from Lendbank as the only floating charge holder with regards to restructuring of assets secured under their charge, and a separate approval from majority of Lendbank, Victory and other non-secured creditors for all other assets that fall under the general estate.

It is unclear what other assets belongs to Elbow that is available to creditors. Regardless, one way for Elbow to raise funds is to have a pre-packaged sale, in particular, the sale of Elbow's subsidiaries which would also reassign its debts owed to Lendbank. This will require approval of majority of secured creditor, in this case, approval solely from Lendbank.

Apart from reduction or shareholder's capital, a company can also implement a debt-for-equity swap.

GOOD ANSWER – 8 MARKS

TOTAL MARKS = 48 MARKS OUT OF 50

*** End of Assessment ***