

# Bermuda

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## FORMS OF SECURITY

1. **What are the most common forms of security granted over immovable and movable property? Are there formalities that the security documents, the secured creditor or the debtor must comply with? What is the effect of non-compliance with these formalities?**

### Immovable property

**Common forms of security.** The most common forms of security taken over immovable property are:

- **Mortgages.** There are two forms of mortgage:
  - **Legal mortgage.** This is the main form of security interest taken over immovable property. The mortgage transfers legal title to a debtor's property to the creditor as security for a debt. The debtor retains possession of the property and recovers legal ownership when it satisfies the secured debt in full and obtains a reconveyance of the legal estate;
  - **Equitable mortgage.** The mortgage transfers the beneficial interest in the debtor's property, and not the legal title, to the creditor. An equitable mortgage does not take priority over a third party who, without notice of the security interest, subsequently acquires legal title to the property in good faith and for value.
- **Fixed charge.** The creditor is given a right to take possession of the charged property (including the right of sale) on the occurrence of a specified event of default. The legal title over the property is not transferred to the creditor.

On the occurrence of a default, the creditor can sell the charged property and use the proceeds to satisfy the amounts due to it from the debtor without reference to other creditors and regardless of whether the debtor is subsequently liquidated. The charged property is not deemed to be an asset of the debtor in the event of insolvency.

The debtor cannot dispose of any property that is subject to a fixed charge without the creditor's consent. The charge will be released once the debt has been discharged in full.

**Formalities.** Legal mortgages over certain property must be created by deed. Equitable mortgages and fixed charges are generally created by deed. Deeds can be executed either under company seal or by a duly authorised signatory or signatories.

Mortgages and charges over real property are submitted to the Office of the Registrar General. The order in which mortgages are deposited governs the priority of mortgages. Charges can also be registered with the Registrar of Companies. They do not need to be registered to ensure the validity and enforceability of the security interest. Registration, however, will ensure priority over unregistered charges and over subsequently registered charges.

### Movable property

**Common forms of security.** The most common forms of security taken over movable property are:

- **Mortgages.** See above, *Immovable property*. Mortgages over movable property are most common for property such as ships and aircraft.
- **Fixed charges.** See above, *Immovable property*.
- **Floating charges.** A floating charge can be taken over different classes of assets that change from day to day. Typically, a floating charge is taken over a debtor's entire business and undertaking.

Unlike a fixed charge, a floating charge does not attach to a particular asset, but floats over one or more assets. While the floating charge is in place, the debtor can dispose of the secured assets without the creditor's consent. However, on the occurrence of a specified event of default, the floating charge will crystallise and convert into a fixed charge that attaches to the debtor's specific assets at that time. The property secured by a floating charge forms part of the debtor's assets in the event of insolvency.
- **Pledges.** A pledge gives a creditor the right to take possession of the pledged asset and to sell it in the event of the debtor's default.
- **Lien.** A lien gives a creditor the right to retain possession of an asset until the debt is satisfied. However, the creditor is not entitled to sell the asset in the event that the debtor defaults.

**Formalities.** Mortgages are generally created by deed. Specific registration rules apply to mortgages over certain assets, such as aircraft and ships. The date of registration governs the order of priority.

Fixed and floating charges can be created in writing but are usually created by deed. They can, but do not have to be, registered with the Registrar of Companies. Registration will ensure priority over unregistered charges and over subsequently registered charges.

Pledges are created by contract and perfected by actual (or constructive) delivery of the pledged asset to the creditor (for example, the delivery of stock certificates to transfer possession of shares).

Liens are created by:

- Contract.
- Statute, in the case of certain types of creditors, such as solicitors.
- The common law, for example, a workman's lien on the item worked on.

There are specific registration requirements, in certain cases, for security interests created over the assets of partnerships.

## CREDITOR AND SHAREHOLDER RANKING

### 2. Where do creditors and shareholders rank on a company's insolvency?

Assets secured by a mortgage or fixed charge are outside the scope of an insolvency as they are not assets to which the company is beneficially entitled. The secured debts are satisfied from the proceeds of sale of the property. The liquidator, however, will typically:

- Review the circumstances of the creation of the security to ensure that it is valid.
- Seek repayment of any sums recovered that are above the amount payable to the creditor under the mortgage or fixed charge.

If the proceeds from the sale of the property do not fully satisfy the debt secured by the mortgage or fixed charge, the secured creditor is an unsecured creditor for the remainder of the debt (*see below*).

Creditors and shareholders are paid in the following order:

- **Costs of insolvency proceedings.** This includes all costs, charges and expenses properly incurred in the company's winding-up, including the liquidator's remuneration (*section 232, Companies Act 1981 (CA)*).
- **Employees' debts.** These are sums due to employees under the terms of their employment contract (*Employment Act 2000*).
- **Preferential payments.** These include:
  - unpaid taxes;
  - contributions to occupational pension schemes under the Contributory Pensions Act 1970; and
  - liability for compensation under the Workmen's Compensation Act 1965, for example, compensation for injury or occupational disease.
- **Debts secured by a floating charge.** Although creditors whose interest is secured by a floating charge take priority over unsecured creditors, they are specifically subordinated to the higher priority claims, which must be paid out of property secured by a floating charge if the assets of the company are not otherwise sufficient to meet them (*section 236, CA*).

- **Unsecured debts.** These include shareholder loans and loans by affiliated companies.
- **Shareholders' debts.** These are debts due to shareholders in their capacity as shareholders.
- **Shareholders' equity.** Any residual value after all claims of creditors have been satisfied in full is returned to shareholders.

Each category of debts must be paid in full before payment of creditors in the subsequent category. Creditors in the same category rank equally among themselves.

A company can enter into an agreement with its creditors under which certain debts are contractually subordinated to other debts.

## UNPAID DEBTS AND RECOVERY

### 3. Do trade creditors use any mechanisms to secure unpaid debts?

#### Retention of title clause

A retention of title clause in a contract is the principal mechanism that trade creditors use to secure their debts. It permits a creditor to retain legal title to goods supplied to the debtor until they have been paid for. This payment can be for either:

- The specific goods.
- More usually, for all outstanding amounts due to the creditor (all monies clause).

While in the debtor's possession, the goods must:

- Remain capable of being identified.
- Not be transformed into other property or sold to a third party.

#### Charges and liens

Charges and liens can be created over specific assets (*see Question 1*).

### 4. Can creditors invoke any procedures (other than the formal rescue or insolvency procedures described in Question 6) to recover their debt? Is there a mandatory set-off of mutual debts on insolvency?

#### Debt recovery

Creditors can use the following methods to recover their debt:

- **Receivership.** A holder of a fixed or floating charge can, if the charging document specifically provides for this, appoint a receiver over the company's charged assets in the event of a debtor's default. The receiver will act under the

powers set out in the charge document (which will typically include a right of sale). It will usually realise the value of the charged asset and repay the creditor the amount of its unpaid debt.

- **Court proceedings.** A creditor who is owed a liquidated debt can bring proceedings in the Supreme Court of Bermuda. If the debt is undisputed, the creditor can seek summary judgment against the debtor. If the creditor can demonstrate to the court that there is a real danger that the debtor will dissipate the assets, it can also apply for an injunction to freeze the assets up to the value of the claim.

In certain limited circumstances, a court can appoint a receiver to manage the debtor's affairs while court proceedings are pending.

A creditor who has successfully obtained a judgment against a debtor (a judgment creditor) can have the judgment enforced by, for example:

- court officials seizing the debtor's assets;
- obtaining a court order to garnish sums due to the debtor (for example, bank account balances or debts due from a third party).

It is possible to convert judgments obtained in certain jurisdictions (for example, the UK and some other commonwealth countries) into a Bermuda judgment through a simple registration procedure under the Judgments (Reciprocal Enforcement) Act 1958. For judgments obtained in other jurisdictions, it will be necessary to start fresh proceedings in the Supreme Court.

### Mandatory set-off

In a liquidation there is a mandatory set-off where there have been mutual credits, mutual debts or other mutual dealings between the company and a creditor. The set-off extends to non-contractual claims as well as debts. In respect of mutual dealings an account is taken of what is due from one party to the other.

## STATE SUPPORT

### 5. Is state support for distressed businesses available?

There is no official or formal state support available for distressed businesses. However, the Small Business Development Corporation (a joint venture between Bermuda's banks and the government which provides business advice and financial assistance to the small business sector) can offer support in the form of guarantees on business loans on an ad hoc and entirely discretionary basis.

## RESCUE AND INSOLVENCY PROCEDURES

### 6. In relation to each available rescue and insolvency procedure:

- **What is its objective and, where relevant, what are the prospects for recovery?**
- **How is it initiated, when, by whom and which companies can it be applied to?**
- **Can the company obtain any protection from its creditors during the procedure?**
- **What substantive tests apply?**
- **How long does it take?**
- **What consents and approvals are required?**
- **Who supervises the procedure and controls the company's affairs (for example, an independent accountant or the court)?**
- **How does it affect the company, shareholders, employees, trading partners and creditors?**
- **How is the procedure formally concluded and what happens to the company on conclusion?**

### Scheme of arrangement

**Objective.** The objective of a scheme of arrangement is for a company to restructure its debt and/or equity by making a binding compromise or arrangement with its creditors and/or shareholders. Although it is not strictly an insolvency procedure, it is frequently used in this context. A scheme is available to both solvent and insolvent Bermuda companies.

**Initiation.** Only the company itself can initiate a scheme. In the case of an insolvent company, however, the liquidator will propose the scheme rather than the company's board of directors.

Proceedings are started by applying to the Supreme Court for directions to convene meetings with the various classes of creditors and/or shareholders who will be affected by the scheme's proposals.

There is no obligation to commence a scheme (*see below, Liquidation: Initiation*).

**Protection from creditors.** There is no automatic stay preventing actions against the company during the period when the scheme is being proposed and implemented.

**Substantive tests.** There are no substantive tests (it is not necessary to show that the company is insolvent).

**Length of procedure.** The scheme's duration will depend on the:

- Complexity of the company's affairs.
- Proposals put forward.
- Scheme's purpose.

**Consents and approvals.** Approval requires a majority in number and representing 75% in value of those present (either in person or by proxy) and voting at each class meeting, to vote in favour of the scheme. If approved, an application is then made to the Supreme Court to sanction the scheme.

The court must be satisfied that the:

- Applicable statutory provisions have been complied with.
- Scheme is fair.

If there are no objections to the scheme, the court will generally accept that it is fair on the basis that the requisite majorities have approved it. A copy of the sanction order must be:

- Delivered to the Registrar of Companies for the scheme to be effective.
- Annexed to any copies of the company's memorandum of association issued subsequent to the order.

**Supervision and control.** This depends on whether the company is insolvent:

- Insolvent: a winding-up petition is typically presented to the court in advance of the scheme and a provisional liquidator appointed. The provisional liquidator can have the power to put forward the scheme, or his powers can be limited to overseeing the company's board and management. If the company is solvent at the conclusion of the scheme, the winding-up petition will be dismissed and the provisional liquidator released.
- Solvent: the company's ordinary management is in place and normal principles of corporate governance apply.

**Effect.** Once the court has sanctioned the scheme and it is lodged with the Registrar of Companies, it is binding on the company and all of the affected creditors and shareholders, regardless of whether they voted or were aware of its proposals.

**Conclusion.** Once the scheme's terms have been carried out, the company continues to operate, either as a going concern or in liquidation, subject to changes imposed under the scheme's terms.

## Liquidation

**Objective.** Liquidation procedures can be divided into compulsory and voluntary liquidations (see below, *Initiation*). The purpose of both is to realise assets, pay-off creditors, and distribute any remaining assets to the shareholders. The company can then be dissolved and will cease to exist.

**Initiation.** Liquidation proceedings are initiated as follows:

- **Compulsory liquidation.** This is initiated by one of the following making a petition to a Bermuda court:
  - a creditor, including any contingent or prospective creditor;
  - a contributory (that is, any person liable to contribute to the assets of the company in the event of its liquidation);
  - the company itself (by a shareholders' resolution if solvent and/or a directors' resolution if insolvent);
  - in certain circumstances, the Registrar of Companies or the Supervisor of Insurance.

- **Voluntary.** There are two types of voluntary liquidation: members' voluntary liquidation (MVL), under which a solvent company is wound up under the control of its shareholders, and a creditors' voluntary liquidation (CVL), which is driven by creditors of a company. They are initiated by the company's shareholders through a resolution, based on the recommendation of the board of directors, although creditors participate in the CVL procedure.

Directors are not required to file liquidation proceedings where a company becomes insolvent. Failure to do so, however, can result in them incurring personal liability for breach of their fiduciary duty, fraudulent trading and/or misfeasance (see *Question 8*).

Compulsory and voluntary liquidations are available to all companies registered in Bermuda. It is unclear whether, and in what circumstances, Bermuda courts can make a compulsory winding-up order in respect of a foreign-registered company (although there have been two uncontested cases in which orders have been made).

**Protection from creditors.** In a compulsory liquidation, once a winding-up order is made or a provisional liquidator appointed, an automatic stay prohibits creditor action. Secured creditors, however, are still entitled to enforce their security (see *Question 2*).

The automatic stay does not apply in voluntary liquidation. However, the court can consider a liquidator application to grant a stay of creditor action from the date of the shareholders' resolution, which is when the MVL or CVL is deemed to commence (see above, *Initiation*).

**Substantive tests.** Persons filing for compulsory liquidation or a CVL must demonstrate that the company is, or is likely to become, unable to pay its debts when due. This test can be satisfied:

- On a cash flow basis (the company is unable to pay its liabilities as they become due) or balance sheet basis (the realisable value of the company's assets is less than the aggregate of its liabilities and its issued share capital and share premium accounts).
- By proof of an unpaid debt (as evidenced by a court judgment or a statutory demand for payment).

The Bermuda court can also put a company into liquidation if it can be shown that it is just and equitable to do so.

When applying for an MVL, a majority of the directors must make a statutory declaration confirming that they believe that the company will be able to pay its debts in full within 12 months from the date of commencement of the liquidation.

**Length of procedure.** A compulsory liquidation or CVL's duration depends on the complexity of the company's affairs and the nature of its debts and assets. An MVL typically takes between eight to 12 weeks.

**Consents and approvals.** In the case of a compulsory liquidation, the court will make a winding-up order following the petition for winding-up.



MVLs and CVLs require the shareholders of the company to approve the liquidation by a simple majority vote (unless the company's bye-laws specifically provide otherwise). In a CVL, a creditors' meeting must be held within 24 hours of the shareholders' resolution. At that meeting, a majority by value of the creditors present and voting appoint the liquidator and may also appoint a committee of inspection and fix the liquidator's remuneration.

**Supervision and control.** Once proceedings have started, the court may appoint a provisional liquidator (*see Question 10, Authority*). After a winding-up order is made, in both voluntary and compulsory liquidation a liquidator is appointed (usually at the first creditors' meeting) to conduct the liquidation. In the case of an MVL the liquidator conducts the liquidation for the benefit of shareholders, and in the case of a CVL for the benefit of the creditors. Once in office, a liquidator is empowered to sell the company's assets without approval of the court or the creditors. If appointed, a committee of inspection, which represents the interests of the creditors and contributors, will provide directions to the liquidator in relation to the administration of the assets of the company and their distribution among creditors.

**Effect.** Both liquidation processes involve the liquidator taking over the company's management. In voluntary liquidation, an MVL is basically an administrative process that involves repaying all creditors and distributing any remaining assets to the shareholders. A CVL is a creditor-driven process.

**Conclusion.** Once the liquidator has realised all the company's assets, paid any amounts due in respect of preferential payments, made distributions to creditors and distributed any balance to shareholders, he must comply with certain formalities.

- Compulsory liquidation: the liquidator must apply for a release from the court. In doing so, the liquidator must:
  - give creditors and shareholders 21 days' notice of his intention to make the application;
  - provide an account of the liquidation with that notice.
- CVL: the liquidator must convene final creditors' and shareholders' meetings. Within seven days of the meetings, the liquidator must notify the Registrar of Companies of the meetings and provide an account of the liquidation.
- MVL: the company is deemed dissolved following the final general meeting (FGM) of the shareholders. The liquidator must notify the Registrar of Companies of this within seven days of the FGM.

## STAKEHOLDERS' ROLES

### 7. Which stakeholders have the most significant role in the outcome of a restructuring or insolvency procedure?

In a liquidation (whether compulsory or voluntary) the unsecured creditors play a significant role. In a CVL they can determine the course of the liquidation through their representatives on the committee of inspection. In a scheme of arrangement, the unsecured creditors and the directors (acting with a view to the best interests of both creditors and shareholders) will play the most significant roles.

## LIABILITY

### 8. Can a director, parent company (domestic or foreign) or other party be held liable for an insolvent company's debts?

A director or parent company can be held liable for the debts of an insolvent company, as part of the statutory provisions intended to protect the assets of a company for the benefit of the creditors.

#### Directors' liability

Criminal offences by officers of companies in liquidation that give rise to liability include (*sections 243 to 247, CA*):

- Failing to fully disclose to the liquidator all details regarding the company's property.
- Failing to deliver up such property as the liquidator directs.
- Concealing and/or removing company property.
- Fraudulently altering documents relating to company property or affairs.
- Falsifying books or accounts with the intention of defrauding any person.

Directors can be liable if, during the course of the winding-up of a company, it appears that the company has intentionally carried on its business with the intention of defrauding its creditors or for any other purpose (fraudulent trading). In that case, the court has the discretion to order that any person who was knowingly a party to the carrying on of business be personally liable for the debts, or part of the debts, or other liabilities of the company. In this respect, the court can summon before it:

- Any officer of the company, or person known or suspected to have in his possession any property of the company.
- Any person whom the court considers capable of giving information concerning the company's promotion, formation, trade, dealings, affairs or property.

The court can examine such persons under oath orally or through written interrogatories.

The court, on the application of the Official Receiver or liquidator, has statutory jurisdiction to compel repayment with interest from an officer or director of a company who has:

- Misapplied company property or money.
- Been guilty of any misfeasance or breach of trust in relation to the company.

Penalties for company directors or officers convicted of any of the above offences range from monetary fines to imprisonment (for periods ranging from 12 months to five years).

In certain circumstances, directors can be held personally liable for employees' unpaid pension contributions and unpaid taxes.

#### Parent company liability

There are no circumstances in which a parent company can be held liable for an insolvent company's debts. The liability of the parent is limited to the amount paid up (or to be paid up) on its shares in the company.



## SETTING ASIDE TRANSACTIONS

9. Can an insolvent company's pre-insolvency transactions be set aside? If so:

- Who can challenge these transactions, when and in what circumstances?
- Are third parties' rights affected?

### Avoidable transactions

The following transactions entered into by a company that subsequently becomes insolvent can be set aside, with the aim of clawing back the proceeds to restore the company to the position that it was in prior to the transaction:

- **Fraudulent preferences (section 237, CA).** Any conveyance or other disposition of property made by execution (including any inter-group disposition) within six months prior to the commencement of its winding-up is void if it was made:
  - with the intention to fraudulently prefer one or more of the company's creditors;
  - at the time that the company was unable to pay its debts as they became due.

A conveyance or assignment by a company of all its property to trustees for the benefit of its creditors is effectively void. Applications concerning fraudulent preferences are most likely to be brought by the liquidator.

- **Unlawful floating charges (section 239, CA).** A floating charge is considered invalid and can be set aside where it can be shown that it was created:
  - within 12 months of the commencement of insolvency proceedings; and
  - for no consideration.

Applications concerning unlawful floating charges are most likely to be brought by the liquidator.

- **Fraudulent conveyances (sections 36A to 36G, Bermuda Conveyancing Act 1983).** An eligible creditor can set aside a transaction or disposition of property at an undervalue where it can be shown that the transferor's dominant purpose was to put the property beyond the creditors' reach. An eligible creditor is a person who:
  - is owed a debt by the transferor on, or within two years after, the transfer;
  - on the date of the transfer is owed a contingent liability by the transferor, where the contingency giving rise to the obligation has occurred; or
  - on the date of the action to set aside the transfer is owed an obligation arising from a cause of action which occurred prior to, or within two years after, the date of the transfer.
- **Disclaimer of onerous/unprofitable contracts (section 240, CA).** The liquidator of a company can, with the court's permission, disclaim any property or contracts that it considers to be onerous, unprofitable or unsaleable.

### Third parties

Third parties who buy property from parties who enter into contracts with a company that later becomes insolvent obtain good title if the property they obtain was purchased in good faith and for valuable consideration.

## CARRYING ON BUSINESS DURING INSOLVENCY

10. In what circumstances can a company continue to carry on business during insolvency or rescue proceedings? In particular:

- Who has the authority to supervise or carry on the company's business?
- What restrictions apply?

### Authority

Once a liquidation has commenced (voluntary or involuntary), the court can appoint a provisional liquidator. This may be the Official Receiver (a government officer, presently the Registrar of Companies) or some other fit and proper person. After a winding-up order is made, the first creditors' meeting will usually vote on the appointment of a permanent liquidator (or joint liquidators). This is usually a chartered accountant in a local firm of accountants. When the company has assets and creditors in foreign jurisdictions, it is usual for the local accountant to act jointly with a chartered accountant from an affiliated firm in the foreign jurisdiction. The liquidator can, among other things, enter into compromises with the company's creditors, sell the company's property, raise money using the company's assets as security and, in certain circumstances, continue the business of the company (see below, *Restrictions*).

If a solvent company has entered into a scheme of arrangement, however, its usual management will be in charge without the need for the appointment of a liquidator.

### Restrictions

In liquidation, the liquidator can carry on the business of the company where this is necessary for a beneficial winding-up.

Where a scheme of arrangement is in place for an insolvent company, the company's directors can carry on the company's business where they believe that the scheme will result in a reorganisation that is in the creditors' best interests and will enable the company to continue to operate. Parties to transactions involving an insolvent company must be informed that the company is involved in insolvency proceedings and this must be made clear on all company correspondence.

## ADDITIONAL FINANCE

11. Can a company that is subject to insolvency proceedings obtain additional finance (for example, debtor-in-possession financing or equivalent)? Is special priority given to the repayment of this finance?

In liquidation, the liquidator of a company can raise finance to the extent that this is necessary for the beneficial winding-up of the company. This is common, and often advisable. Repayment of this finance depends on the negotiated terms, but would usually take priority over the existing creditors.

In a scheme of arrangement, the company may obtain additional financing from its existing creditors.



## MULTINATIONAL CASES

### 12. In relation to multinational cases:

- Do local courts recognise insolvency and rescue procedures in other jurisdictions, and court judgments made during these procedures? Is recognition given under specific legislation or under case law (for example, principles of comity)?
- Do courts co-operate where there are concurrent proceedings in other jurisdictions?
- Is your jurisdiction party to any international treaties, model laws or EU legislation (if applicable)?
- Are there any special procedures that foreign creditors must comply with when submitting claims in local insolvency proceedings?

#### Recognition

There is no statutory provision requiring the Bermuda courts to recognise foreign proceedings. However, the Bermuda courts have discretion to do so: for example, they have recognised proceedings brought in the US under Chapter 11 of the United States Bankruptcy Code.

#### Concurrent proceedings

There is no statutory provision regarding the treatment of concurrent proceedings in other jurisdictions. Bermuda courts, however, have co-operated with foreign proceedings, allowing them to take the lead role where it can be shown that to do so would be in the best interests of the company.

#### International treaties

Currently, Bermuda is not a signatory to any international treaties relating to insolvency.

#### Procedures for foreign creditors

Foreign creditors can claim within Bermuda proceedings for debts owing to them, although any distribution received in foreign proceedings must be offset against any claim brought within the Bermuda courts.

## REFORM

### 13. Are there any proposals for reform?

There are currently no substantive proposals for reform.

## CONTRIBUTOR DETAILS



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**Qualified.** England and Wales, 1998

**Areas of practice.** Mergers and acquisitions; banking and finance; restructuring and insolvency.

#### Recent transactions

- Advising Intelsat Ltd, the fixed satellite services provider and successful bidder in a public auction, in relation to the acquisition of the ProtoStar 1 satellite from ProtoStar 1 Ltd, a Bermuda company subject to US Chapter 11 proceedings and provisional liquidation in Bermuda.
- Advising Alinta Energy Group, the power generation business, in relation to the comprehensive restructuring of its secured debt facility.



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**Areas of practice.** Commercial litigation; restructuring and insolvency.

#### Recent transactions

- Acting for various hedge funds in connection with claw-back claims by the Trustee in Bankruptcy of Bernard L Madoff Investment Securities.
- Acting for various hedge funds in connection with claims against HSBC for losses arising from Madoff fraud.
- Acting for the liquidators of a large multinational container leasing company.
- Acting for Petitioner to wind-up a Bermuda incorporated hedge fund.

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