GUIDE

APPLEBY

GUIDE TO INSOLVENT LIQUIDATIONS IN BERMUDA

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PREFACE

A number of separate procedures are available to various interested parties upon the insolvency of a company in Bermuda. This Guide discusses the two statutory liquidation proceedings, namely, winding-up by the court and creditors' voluntary winding-up.

We recognise that this Guide will not completely answer detailed questions which clients and their advisers may have; it is not intended to be comprehensive. If any such questions arise in relation to the contents, they may be addressed to John Riihiluoma, a Partner and the Local Team Leader (Commercial Dispute Resolution) in the Bermuda office, using the contact information provided at the end of this Guide.

Appleby
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1. INTRODUCTION

A number of separate procedures are available to various interested parties upon the insolvency of a company in Bermuda. There are two statutory procedures, a compulsory winding-up by the court and a creditors' voluntary winding-up. In addition, a secured creditor may be entitled to exercise a private contractual right to appoint a receiver of assets subject to debenture or similar security. This Guide will discuss only the two statutory liquidation proceedings, namely, winding-up by the court and creditors' voluntary winding-up.

After introducing the two liquidation procedures and describing the respective processes by which each commences, the Guide will consider insolvency related issues.

2. STATUTORY LIQUIDATION PROCEDURES: AN OVERVIEW

A winding-up by the court, also referred to as a compulsory winding-up or liquidation, commences following the filing with the court of a petition presented by the company, one or more creditors or the Registrar of Companies (**Registrar**).

A creditors' voluntary winding-up, on the other hand, occurs in any case where (a) it has been decided by members of a company to wind-up the company, and (b) it is determined that the company is insolvent. In these circumstances, a meeting of creditors must be convened and the creditors consider whether to appoint a liquidator or joint liquidators for the purpose of winding-up the affairs of the company.

3. COMPULSORY WINDING-UP

3.1 Jurisdiction

Insolvency is not the only ground upon which a company may be wound-up by the court. A company may be wound-up on the grounds of insolvency by the court if:

- the company resolves that the company shall be wound-up by the court; or
- the company is unable to pay its debts.

3.2 Standing

The company, a creditor (including a contingent or prospective creditor) and a contributory (essentially any member) all have standing to present a petition for the compulsory winding-up of a company.

In addition, where the ground for the filing of a petition is default in the holding of a statutory meeting, only a member may present the petition. Further, where the petitioner is a creditor having only contingent or prospective claims against the company security for costs must be given, and it must be established that there is a *prima facie* case for the winding-up of the company.

As a general rule, a contributory cannot petition on the ground of the insolvency of the company because a contributory has no interest in the winding up of the company.

The board of directors of a company can petition on behalf of a company in the event of insolvency.

3.3 Appointment of Liquidator

Upon the presentation of a winding-up petition, a court may appoint a provisional liquidator who may be the Official Receiver (a government officer, presently the Registrar) or any other fit person. There are no licensing requirements or prescribed qualifications for liquidators, although the practice is to appoint

chartered accountants specialising in insolvency or other professionals. If the court appoints no provisional liquidator upon the granting of a winding-up order, then the Official Receiver becomes the provisional liquidator.

The provisional liquidator must summon separate meetings of the creditors and contributories of the company for the purpose of determining (a) whether an application should be made for an order appointing a permanent liquidator (or joint liquidators) and, as a practical matter, (b) the identity of a person or persons they wish to be appointed. An application may then be made for an order giving effect to the wishes of the creditors and contributories. If the wishes of the creditors appear inconsistent with those of the contributories, the court must resolve the difference and may make any order it thinks fit. If no liquidator is appointed by the court, the Official Receiver will be the liquidator.

3.4 Obligations of the Liquidator

The liquidator of the company is obliged to obtain and assume control of all property to which the company appears to be entitled to, ascertain the creditors of the company and facilitate the payment of *pari passu* dividends. The liquidator will also have the power, with the approval of either the court or of the committee of inspection to:

(a) commence or defend legal action or proceedings in the name and on behalf of the company;

(b) carry on the business of the company so far as necessary for its beneficial winding-up;

(c) appoint an attorney to assist the liquidator in the performance of their duties;

(d) pay any class of creditors in full; and

(e) enter into compromises or arrangements with creditors, persons alleging any claim and debtors.

3.5 Conclusion of Compulsory Wind Up

In a compulsory liquidation, once the liquidator has realised all of the property of the company and distributed a final dividend, he may apply to the court for an order releasing him and dissolving the company. Upon the making of the order, the liquidation is concluded.

4. CREDITORS' VOLUNTARY WINDING-UP

4.1 Eligibility

A creditors' voluntary winding-up ensues in a case where:

(a) the company in general meeting has passed a resolution requiring the company to be wound-up voluntarily; and

(b) either:

  (i) a statutory declaration of the majority of the directors affirming the solvency of the company has not been made within five weeks prior to the date of the resolution; or

  (ii) the liquidator appointed on behalf of the members takes the view that the company will not be able to pay its debts in full within the period stated in the declaration (not to exceed 12 months).

In the former case, a meeting of creditors of the company must be summoned to be held on the day of, or the day following, the meeting of members. In the latter case, the liquidator must summon a meeting of creditors immediately.

4.2 **Procedure**

The directors of the company must prepare a statement of the company's affairs, as well as a list of creditors showing estimates of their claims, to be laid before the meeting of creditors. In addition, one of the directors must be appointed to preside at the meeting of creditors. The creditors and the company at their respective meetings may nominate a person to be liquidator for the purpose of winding-up the affairs and distributing the assets of the company. If the creditors and the company nominate different persons, the person nominated by the creditors shall be the liquidator. In such a case, however, any director, member or creditor may apply for an order directing that the person nominated by the company or some other person should be appointed instead of or jointly with the person nominated by the creditors.

In addition to nominating a liquidator or joint liquidators, the creditors may (but need not) appoint a committee of inspection of not more than five persons.

4.3 **Obligations of the Liquidator**

The liquidator of the company is obliged to obtain and assume control of all property to which the company appears to be entitled to, ascertain the creditors of the company and facilitate the payment of *pari passu* dividends. The liquidator may, with the sanction of the court or the committee of inspection or, if there is no such committee, a meeting of the creditors, pay any class of creditors in full and enter into compromises or arrangements with creditors, persons alleging any claim and debtors.

4.4 **Conclusion of Creditors' Voluntary Winding-Up**

The liquidator must summon final meetings of the company and the creditors and must lay before the meetings an account of the winding-up. Thereafter, the liquidator must file the account with the registrar. On the expiration of three months from the date of registration of the account, the company is dissolved and the liquidation concluded.

5. RELATED ISSUES TO STATUTORY LIQUIDATION

5.1 Classification of Creditors

(a) **Unsecured Creditors**

The term **unsecured creditor** refers to a creditor of the company that has failed to take any security over the assets of the company to **secure** the debt owed to them by the insolvent company. In contrast, a **secured creditor** is a creditor that has taken such security.

(b) **Secured Creditors**

The position of secured creditors is largely unaffected by an insolvent liquidation. The stay of proceedings, although broad in its sweep, does not extend to preventing secured creditors from exercising their rights in respect of valid security. Should a secured creditor require the assistance of the court to enforce his rights under his security, leave of the court to proceed will be necessary in face of the automatic or court-ordered stay of proceedings, but the secured creditor should have little difficulty in obtaining leave. The preferred position of the secured creditor results from the fact that he enjoys a proprietary interest in assets subject to the security. In other words, these assets do not belong in law (or at least in equity) to the company in liquidation and fall outside the general assets to be collected and distributed for the benefit of ordinary creditors.

If the security held by a secured creditor is insufficient he may, after realising his security, prove in the liquidation for the balance. In addition, if the secured creditor surrenders the security for the general benefit of the creditors, he may prove for his whole debt. Before ranking for dividend,

however, a secured creditor who does not either realise or surrender his security must assess the value of his security. The liquidator may redeem the security at the assessed value or, if he is dissatisfied with the value assessed by the creditor, he may require that the security be offered for sale on terms and conditions agreeable to the creditor and the liquidator or, in the absence of an agreement, as the court may direct. It should be emphasised that these special rules do not apply at all in a case where a secured creditor does not wish to file a proof and to rank for dividend.

(c) **Preferential Creditors/Employees**

In addition to the position of secured creditors whose beneficial treatment follows essentially as a matter of the law of property, a preferred position is accorded to certain **preferential** creditors by virtue of the Companies Act and certain employees under the Employment Act 2000. Debts ranking as preferential claims include taxes owing to the government, rates owing to a municipality, wages or salary, holiday remuneration and amounts due under The Workmen's Compensation Act 1965 and the class of employees will in certain circumstances and subject to certain limits rank in priority to even preferential claims. Although these claims rank ahead of the claims of ordinary creditors, they are generally considered to rank behind claims of secured creditors.

5.2 **Effect of an Order for Winding-Up**

An order for the winding-up of a company will operate in favour of all the creditors and of all the contributories of the company as if made it were made on the joint petition of a creditor and contributory.

5.3 **Scheme of Arrangement**

The Companies Act provides for a procedure whereby a proposal or arrangement between a company and prescribed majorities of its creditors (or its members) or any class of them may become binding on all the creditors (or members) of the affected classes. The procedure may be invoked by a company in liquidation and may be useful in any case where it is desirable to wind up the affairs of the company in a manner which is not entirely consistent with the statutory scheme. The procedure has the attraction that unanimous approval of the affected class or classes of creditors is not required.

In order to bind creditors or any class to a compromise or arrangement, approval must be obtained from a majority in number representing three-fourths in value of the creditors of each affected class of creditors present and voting (in person or by proxy). In addition, the sanction of the Supreme Court of Bermuda is required.

For more specific advice on insolvent liquidations in Bermuda, we invite you to contact:

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For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found here.