



ICLG

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Allen & Overy LLP

Andreas Neocleous & Co LLC

Attorneys at law Borenus Ltd

Baker & Partners

Baspinar and Partners Law Firm

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Debarliev, Dameski & Kelesoska Attorneys at Law

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RESOR N.V.

Rivera Gaxiola, Carrasco y Barrera

Sedgwick Chudleigh Ltd.

Slaughter and May

Uría Menéndez

White & Case LLP



GLG

Global Legal Group

Contributing Editor

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Editors

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Gemma Bridge

Senior Editor

Suzie Levy

Group Consulting Editor

Alan Falach

Group Publisher

Richard Firth

Published by

Global Legal Group Ltd.
59 Tanner Street
London SE1 3PL, UK
Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
Email: info@glgroup.co.uk
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General Chapters:

1	When Is a Company Insolvent under English Law? - Tom Vickers & Megan Sparber, Slaughter and May	1
2	Turning the Tables: Insolvency Law as an Acquisition Tool in Germany - Dr. Gordon Geiser & Christian Köhler-Ma, Olswang LLP	6
3	The Evolution of Just and Equitable Winding Up in Jersey - Stuart Gardner & Linda Johnson, KPMG Channel Islands Limited	11
4	Bankruptcy Mediation: Case Studies, Considerations and Conclusions - James M. Peck & Erica J. Richards, Morrison & Foerster LLP	16

Country Question and Answer Chapters:

5	Australia	Gilbert + Tobin: Dominic Emmett & Nicholas Edwards	22
6	Austria	Fellner Wratzfeld & Partners: Markus Fellner & Florian Kranebitter	29
7	Belgium	Allen & Overy LLP: Koen Van den Broeck & Thales Mertens	35
8	Bermuda	Sedgwick Chudleigh Ltd.: Alex Potts & Nick Miles	41
9	Canada	Osler, Hoskin & Harcourt LLP: Tracy C. Sandler & Caitlin Fell	50
10	Cayman Islands	Campbells: Ross McDonough & Guy Cowan	57
11	China	King & Wood Mallesons: Zheng Zhibin & Zhang Ting	63
12	Cyprus	Andreas Neocleous & Co LLC: Elias Neocleous & Maria Kyriacou	67
13	Denmark	Gorrissen Federspiel: John Sommer Schmidt	73
14	Egypt	El-Borai & Partners: Dr. Ahmed El Borai & Dr. Ramy El Borai	79
15	England & Wales	Slaughter and May: Tom Vickers & Lynda Elms	85
16	Finland	Attorneys at law Borenius Ltd: Mika Salonen & Aleksu Muhonen	97
17	France	Allen & Overy LLP: Rod Cork & Marc Santoni	103
18	Germany	Hengeler Mueller Partnerschaft von Rechtsanwälten mbB: Dr. Ulrich Blech	113
19	Hong Kong	Gall: Randall Arthur & Anjelica Tang	120
20	India	Dhir & Dhir Associates: Purni Marwaha & Varsha Banerjee	126
21	Indonesia	Ali Budiardjo, Nugroho, Reksodiputro: Theodoor Bakker & Herry N. Kurniawan	131
22	Italy	Bonelli Erede Pappalardo: Vittorio Lupoli & Lucio Guttilla	136
23	Japan	Nishimura & Asahi: Yoshinori Ono & Hiroshi Mori	146
24	Jersey	Baker & Partners: David Wilson & Ed Shorrock	153
25	Macedonia	Debarliev, Dameski & Kelesoska Attorneys at Law: Dragan Dameski & Jasmira Ilieva Jovanovikj	158
26	Malta	Camilleri Preziosi: Louis de Gabriele & Nicola Buhagiar	163
27	Mexico	Rivera Gaxiola, Carrasco y Barrera: Béla Kálloí Romero & Alejandro del Castillo Ramirez	169
28	Netherlands	RESOR N.V.: Lucas Kortmann & Karin Sixma	178
29	Portugal	Uría Menéndez – Proença de Carvalho: Pedro Ferreira Malaquias & David Sequeira Dinis	185
30	Puerto Rico	Ferraiuoli LLC: Sonia E. Colón, Esq. & Javier Vilariño Santiago, Esq.	190
31	Spain	Uría Menéndez: Alberto Núñez-Lagos Burguera & Ángel Alonso Hernández	195
32	Sweden	White & Case LLP: Carl Hugo Parment & Michael Gentili	203
33	Switzerland	Lenz & Staehelin: David Ledermann & Tanja Luginbühl	209
34	Togo	Martial Akakpo & Partners, LLP: Martial Akakpo & Arlette Yaitan Figarede	217
35	Turkey	Baspinar and Partners Law Firm: Gökmen Başpinar & Kaan Gök	221
36	Ukraine	Clifford Chance LLC: Olexiy Soshenko & Andrii Grebonkin	228
37	USA	Paul, Weiss, Rifkind, Wharton & Garrison LLP: Alan W. Kornberg & Elizabeth R. McColm	235

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Bermuda



Alex Potts



Nick Miles

Sedgwick Chudleigh Ltd.

1 Issues Arising When a Company is in Financial Difficulties

1.1 How does a creditor take security over assets in Bermuda?

Bermuda is a self-governing British Overseas Territory. The systems of law administered in Bermuda are local Bermudian legislation, Bermudian common law (as developed from English common law), and UK legislation expressly made applicable to Bermuda.

As in other jurisdictions that follow English common law, there are various ways by which a creditor can take security over assets in Bermuda, by agreement between the creditor and the debtor, including by way of: legal mortgage; equitable mortgage; fixed charge; floating charge; pledge; contractual lien; and assignment.

The nature of the security interest in any particular case will be determined by:

- (a) the terms of the parties' agreement, ordinarily set out in the relevant security documents;
- (b) the nature of the property being secured; and
- (c) the nature of the debtor's interest in the property being secured.

In respect of immovable, movable and certain intangible property, a creditor may take, and a debtor may give, security as follows:

Legal mortgage. This results in the legal title to the debtor's property being transferred to the creditor as security for a debt. The debtor remains in possession of the property but only regains legal title upon payment and satisfaction of the debt and reconveyance of legal title by the creditor.

Equitable mortgage. The debtor retains the legal title to, and possession of, the property but transfers the beneficial interest in the property to the creditor. An equitable mortgage does not take priority over a third party who, without notice of the creditor's beneficial interest, acquires the legal title to the property in good faith and for value.

Fixed charge. A creditor can take a fixed charge over property which 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, in the event of a default by the debtor. Upon exercise of the 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 may not deal with any property that is subject to a fixed charge without the consent of the creditor.

In respect of movable and certain intangible property, a creditor can additionally take, and a debtor can give, security as follows:

Floating charge. A floating charge is not fixed to a particular asset (unlike a fixed charge), but 'floats' above a variety of assets. The debtor can sell or dispose of such assets without the creditor's prior consent, but in the event of default by the debtor, the floating charge will 'crystallise' and convert into a fixed charge that attaches to specific assets remaining at that date. Property secured only by a floating charge forms part of the debtor's general assets in the event of an insolvency.

Pledge. A pledge involves the creditor taking actual or constructive delivery or possession of the debtor's assets until the debt is repaid or discharged.

Lien. A lien is the right to retain possession of another person's property until that person performs a specific obligation. A lien is similar to a pledge, save that in the case of a lien, the property is deposited with the creditor not for the purposes of security but for some other purpose, such as safe custody or repair.

An equitable mortgage, or a fixed or floating charge may also be taken over intangible property (such as rights under a contract). Thus an equitable mortgage of an intangible may be effected by equitable assignment by way of security. Equitable assignment will not transfer the right to enforce a contractual right at the suit of the assignee. However, section 19(d) of the Supreme Court Act 1905, which is modelled on section 136 of the UK's Law of Property Act 1925, 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 authorises the assignment of bonds and other debt instruments, and empowers the assignee to bring an action in the name of the assignee against the debtor under the instrument.

Under section 2 of the Charge and Security (Special Provisions) Act 1990, a bank can take security over its own indebtedness to its customers.

1.2 In what circumstances might transactions entered into whilst the company is in financial difficulties be vulnerable to attack?

Payments, transfers of assets, and security transactions can be vulnerable to attack in the event of the company's insolvency or liquidation. Reviewable transactions include fraudulent conveyances, fraudulent preferences, floating charges, onerous transactions, and post-petition dispositions.

Fraudulent conveyances: Sections 36A to 36G of the Conveyancing Act 1983 provide that a creditor of a company may be entitled to apply to have a transaction set aside to the extent required to satisfy its claim provided that the dominant intention of the transaction was to put the property beyond the reach of other creditors and the transaction was entered into for no value or significantly less than the value of the property transferred. For these purposes, a creditor is one to whom an obligation is owed at the date of the transfer, or to whom it is reasonably foreseeable an obligation will be owed within two years of the date of the transfer, or to whom an obligation is owed pursuant to a cause of action which accrued before, or within, two years after the date of the transfer.

Fraudulent preferences: Section 237 of the Companies Act 1981 provides that any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within six months before the commencement of its winding up shall be deemed a fraudulent preference of its creditors and be invalid accordingly. Section 238 provides for the liability and rights of fraudulently preferred persons. In order to fall foul of the provision, the transfer or disposition must have been made within the six months prior to the commencement of the winding up. In the case of a compulsory winding up, this would be the date of the presentation of the petition to the Supreme Court of Bermuda. The transfer will be invalid if it was carried out with the dominant intention of preferring one creditor over others at a time when the company was unable to pay all of its creditors in full.

Floating charges: Section 239 of the Companies Act 1981 provides that a floating charge on the undertaking or property of a company created within 12 months of the commencement of the winding up shall be invalid, unless it is proved that the company immediately after the creation of the charge was solvent, except to the amount of any cash paid to the company at the time of, or subsequently to, the creation of the charge, together with interest at the statutory rate.

Onerous transactions: Section 240 of the Companies Act 1981 provides that the liquidator of a company can, with the Court's permission, disclaim any property belonging to the company or any rights under any contracts which he considers to be onerous for the company to hold, or is unprofitable or unsaleable.

Post-petition dispositions: Section 166 of the Companies Act 1981 provides that, in a compulsory winding up, any disposition of the property of a company, including things in action, and any transfer of shares or alteration in the status of the members of the company, made after the commencement of the winding up (being the time of presentation of the petition) shall be void, unless the Court otherwise orders by way of a validation order. There are four elements which must be established before a validation order may be made: first, the proposed disposition must appear to be within the powers of the company's directors; second, the evidence must show that the directors believe the disposition is necessary or expedient in the interests of the company; third, it must appear that the directors in reaching that decision have acted in good faith; and fourth, the reasons for the disposition must be shown to be ones which an intelligent and honest director could reasonably hold.

1.3 What are the liabilities of directors (in particular civil, criminal or disqualification) for continuing to trade whilst a company is in financial difficulties in Bermuda?

Directors' duties are principally owed to the company itself. To the extent that the company is solvent, such duties are ordinarily owed to the company for the benefit of its present and future shareholders. When the company enters the zone of insolvency, directors must act

in the best interests of the company's creditors. Directors that allow a company to continue to trade while it is in financial difficulties face a range of potential liabilities, depending on the precise circumstances and the relevant director's conduct and state of mind.

Fraudulent trading: Section 246 of the Companies Act 1981 provides that any director that has knowingly caused or allowed a company to carry on business with intent to defraud creditors of the company or for any fraudulent purpose may be found personally liable for all, or any, of the debts or other liability as the Court may direct. This would include carrying on the business of the company when it is known to be insolvent.

Personal liability for fraudulent conveyances/fraudulent preferences: It is possible that directors might be held to be personally liable, in certain circumstances, for fraudulent conveyances or fraudulent preferences, as discussed above.

Breach of fiduciary duty and failure to exercise reasonable skill and care: Directors owe duties to the company both pursuant to section 97 of the Companies Act 1981, and as a matter of common law, to act honestly and in good faith with a view to the best interests of the company (which can include the interests of the company's creditors when the company is in the zone of insolvency), and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Failure to comply with these obligations may result in personal liability on the part of directors.

Misfeasance and breach of trust: Section 247 of the Companies Act 1981 provides that a director may be personally liable if he has misapplied, or retained, or become liable, or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company.

Miscellaneous offences and liabilities: Sections 243 to 248 of the Companies Act 1981 set out a range of criminal offences that may be committed by directors of companies, including, for example, by fraudulently altering documents relating to company property or affairs, falsifying books or accounts with the intention of defrauding any person, or fraudulently inducing a person to give credit to the company. There are also various legislative provisions that impose personal liability on directors for any failure to pay certain taxes and remit pension contributions.

Segregated accounts companies representatives: Section 10 of the Segregated Accounts Companies Act 2000 requires a segregated account representative to 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 of a segregated accounts company for which he acts becoming insolvent, and section 30 makes it a criminal offence to fail to do so.

2 Formal Procedures

2.1 What are the main types of formal procedures available for companies in financial difficulties in Bermuda?

The formal procedures available for companies in financial difficulties are principally contained in the Companies Act 1981 (the winding up provisions of which are substantially modelled on the UK's Companies Act 1948). Some provisions of the Bankruptcy Act 1989 are also applied to companies, by virtue of section 235 of the Companies Act 1981. There are also specific provisions relating to insurance companies in the Insurance Act 1978 and relating to segregated accounts companies and their general and segregated accounts in the Segregated Accounts

Companies Act 2000. The rules relating to compulsory winding up of companies are contained in the Companies (Winding-Up) Rules 1982 and also, to a lesser extent, in the Rules of the Supreme Court 1985.

Liquidation procedures can generally be divided into compulsory liquidations and voluntary liquidations. Voluntary liquidations can, in turn, be divided into solvent liquidations (members' voluntary liquidations) or insolvent liquidations (creditors' voluntary liquidations).

The general purpose of the liquidation process is to gather in and realise assets, to pay off creditors in accordance with their rights and priorities, and then to distribute any remaining assets to the company's shareholders.

Liquidators are generally given a degree of discretion as to the time period within which to effect and complete the liquidation, which may depend to some extent on the nature, location, and liquidity of the company's assets. After the liquidation process is complete, the company can then be dissolved and it will cease to exist as a legal entity.

Voluntary liquidation

There are two types of voluntary liquidation: members' voluntary liquidation, under which a solvent company is wound up under the control of its shareholders; and creditors' voluntary liquidation, which is driven by creditors of a company in the event of the company's insolvency.

Voluntary liquidation is initiated by the company's shareholders through a resolution, based on the recommendation of the board of directors.

Although creditors participate in the creditors' voluntary liquidation procedure, they can only secure the active supervision of the Court by petitioning for the compulsory liquidation of the company.

Compulsory liquidation

The compulsory liquidation process is initiated by one of the following making a petition to the Supreme Court of Bermuda: 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, i.e. a shareholder or member); the company itself (by a shareholders' resolution if it is solvent and/or by a directors' resolution if it is insolvent); and, in certain circumstances, the Registrar of Companies or the Supervisor of Insurance (being the Bermuda Monetary Authority).

It is also possible, in exceptional circumstances, for receivers of segregated accounts within a segregated accounts company to petition for the winding up of the whole company, and also for the Court to wind up a company of its own motion.

Section 170(2) of the Companies Act 1981 also allows the Court to appoint a provisional liquidator between the presentation of a winding up petition and its final hearing.

'Soft-touch' provisional liquidation

It is possible to use a provisional liquidation as a method by which to achieve a corporate restructuring. Under this method, a winding up petition is presented to the Court, usually by the company itself, and a 'soft-touch' provisional liquidator (sometimes referred to as a 'restructuring' liquidator) is appointed with limited powers to supervise the board of directors, pending a final hearing of the winding up petition. Upon appointment of the provisional liquidator, the hearing of the winding up petition is adjourned. The board of directors retains control over the company, and endeavours to effect a restructuring in the meantime, either on a consensual basis or by way of a Scheme of Arrangement, under the supervision of the 'soft-touch' provisional liquidator and the Court. If the

restructuring is successful, the winding up petition can be dismissed; if the restructuring is unsuccessful, the winding up petition can be restored for final hearing and the company can be wound up and placed into full liquidation. This is discussed further in our response to question 7.1 below.

Scheme of Arrangement

Schemes of Arrangement are available under sections 99 to 101 of the Companies Act 1981. The purpose of a Scheme of Arrangement is for a company to restructure its debts and/or its equity by making a binding compromise or arrangement with its creditors and/or its shareholders, subject to the supervision of the Supreme Court of Bermuda. Schemes of Arrangement are available, in principle, to both solvent and insolvent Bermudian companies, whether or not in formal liquidation. The company itself can initiate a scheme, as can any member or creditor. In the case of a company being wound up, the liquidator will usually 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. Approval requires a majority in number, and representing 75 per cent 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. Further details appear in our response to question 7.1 below.

Receivership under the Segregated Accounts Companies Act 2000

Under the Segregated Accounts Companies Act 2000, there is a process whereby segregated accounts can be put into receivership. This is analogous to liquidation of a company, although there are some features of receivership that are unique to the segregated account structure.

2.2 What are the tests for insolvency in Bermuda?

A company is deemed to be insolvent and unable to pay its debts, pursuant to section 162 of the Companies Act 1981, in the following circumstances:

Cash flow insolvency and balance sheet insolvency: If it is proved to the satisfaction of the Court that the company is unable to pay its debts. In determining whether a company is unable to pay its debts, the Court shall take into account the contingent and prospective liabilities of the company. In essence, the Court can take into account both cash flow insolvency (also known as commercial insolvency) and balance sheet insolvency (also known as absolute insolvency).

Failure to pay a statutory demand: If a creditor to whom the company is indebted in a sum exceeding \$500 has served a statutory demand on the company requiring payment, which remains neglected for a period of three weeks.

Unsatisfied execution of judgment: If the execution or other process issued on a judgment of any Court in favour of a creditor of the company is returned unsatisfied.

In the case of insurance companies, section 33 of the Insurance Act 1978 provides that an insurance company carrying on general business is deemed to be unable to pay its debts if at any time the value of its assets does not exceed the amount of its liabilities. In computing the amount of liabilities of an insurance company, all contingent and prospective liabilities shall be taken into account but not liabilities in respect of share capital. Section 33 further provides that, in the case of an insurance company carrying on long-term business as well as general business, the amount of the liabilities of its long-term business at any time shall be taken to be: (a) an

amount equal to the total amount at that time standing to the credit of the insurer's long-term business fund; or (b) the amount of those liabilities at any time as determined in accordance with any applicable regulations, whichever is the greater.

In the case of segregated accounts companies, section 24 of the Segregated Accounts Companies Act 2000 provides that the test of insolvency which applies under section 162 of the Companies Act 1981 and section 33 of the Insurance Act 1978 shall apply, save that assets and liabilities linked to segregated accounts shall not be taken into account. The legislation also provides that, by section 2(2), a segregated accounts company is deemed to be solvent if the general account is able to pay its liabilities as they become due, and a segregated account shall be deemed to be solvent if it is able to pay its liabilities as they become due (excluding obligations to account owners in that capacity). The meaning and effect of these legislative provisions have been the subject of some debate in recent case law.

2.3 On what grounds can the company be placed into each procedure?

A company may be compulsorily wound up by the Court in any of the following circumstances, under section 161 of the Companies Act 1981:

- (a) if the company has, by resolution, resolved that the company be wound up by the Court;
- (b) if there is default in holding the company's statutory meeting;
- (c) if the company does not commence its business within a year of its incorporation or suspends its business for a whole year;
- (d) if the company carries on any restricted business activity;
- (e) if the company engages in a prohibited business activity;
- (f) if the company is unable to pay its debts;
- (g) if the company's ministerial consents were obtained as a result of a material misstatement in the application for consent; or
- (h) if the Court is of the opinion that it is just and equitable that the company should be wound up.

The Supervisor of Insurance (being the Bermuda Monetary Authority) can present a petition for the winding up of an insurance company if it is in breach of the regulatory provisions of the Insurance Act 1978, or if it is in the public interest that the insurance company should be wound up on just and equitable grounds.

Section 34 of the Insurance Act 1978 also provides that the Court may order the winding up of an insurance company subject to the modification that the insurance company may be ordered to be wound up on the petition of ten or more policyholders owning policies of an aggregate value of not less than \$50,000, provided that such a petition shall not be presented except by leave of the Court, and leave shall not be granted until a *prima facie* case has been established to the satisfaction of the Court and until security for costs for such amount as the Court may think reasonable has been given.

The Registrar of Companies can petition for the winding up of a company if directed to do so by the Minister of Finance following receipt of a report of an Inspector to investigate the company under section 132 of the Companies Act 1981.

A provisional liquidator can be appointed prior to the final hearing of a compulsory winding up petition if there is a good *prima facie* case 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.

2.4 Please describe briefly how the company is placed into each procedure.

A compulsory winding up is commenced by the filing of a winding up petition with the Court. The petition normally has to be served on the company, verified on affidavit, advertised publicly, and then heard in open Court. The company is entitled to contest the petition, and the board of directors retains a residual power to contest the petition even if a provisional liquidator has been appointed, and also to appeal any winding up order.

A creditors' voluntary winding up is commenced by a shareholders' meeting followed by a creditors' meeting. A liquidator is appointed by each meeting, with the creditors' choice prevailing in the event of a difference of opinion.

A Scheme of Arrangement is commenced by the company, or its liquidator, filing an application with the Court seeking leave to convene appropriate class meetings of the company's creditors and/or shareholders, for the purpose of considering and voting of the scheme.

2.5 What notifications, meetings and publications are required after the company has been placed into each procedure?

Compulsory liquidation: the liquidator of the company, who is initially described as a provisional liquidator, must convene a meeting of both shareholders and creditors within a month of his appointment. This period can be extended by the Court, and is often extended for an initial period of six months to enable the provisional liquidator to investigate the affairs of the company and collect its assets. The purpose of the first meeting is to appoint a permanent liquidator and a committee of inspection (a committee of creditors) to work with and monitor the liquidator. The liquidator must also call for a statement of affairs to be prepared by the company's former directors and officers, setting out the financial position of the company.

Creditors' voluntary liquidation: the liquidator must convene a meeting of creditors at least once annually during the course of the liquidation, and in any event prior to the company's dissolution.

Scheme of Arrangement: the meeting convened by the Court will be the only meeting held at which time those attending the meeting must vote whether or not to adopt the scheme. There are no further meetings unless the scheme document itself provides for further meetings.

Where a company is in liquidation, every invoice, order for goods or business letter issued by or on behalf of the company or its liquidator shall contain a statement that the company is being wound up, pursuant to section 252 of the Companies Act 1981.

2.6 Are "pre-packaged" sales possible?

A pre-packaged sale involves the pre-agreement of terms of a sale of the business of the company to another party or a new company, which sale is then effected directly after the appointment of an office-holder. The sale and its terms are frequently negotiated by, or with the approval of, major secured creditors of the company.

The prevailing regime in Bermuda does not lend itself to the use of pre-packaged sales. Winding up proceedings anticipate the death of the company and distribution of its assets. Conversely, the Scheme of Arrangement process is too dependent upon the views of the general creditor body. Neither allows the discretion necessary to pre-agree and dictate a disposal of the business of the company, in the manner required for a pre-packaged sale.

Conceivably, a receiver and manager appointed by a secured creditor pursuant to a charge over substantially all the assets of a company may achieve something akin to a pre-packaged sale. It is also conceivable that a Bermudian exempt company whose centre of main interests is in the United Kingdom, or whose assets and liabilities are situated in the United Kingdom, might seek the assistance of both the Courts of Bermuda and the Courts of England and Wales for the purposes of having a pre-packaged sale effected under the supervision of a court-appointed administrator. The procedure, however, is not as common in Bermuda as it is in certain other jurisdictions, such as Jersey, and there is some uncertainty in the case law as to the scope of the power of Bermudian Courts and English Courts in this respect.

3 Creditors

3.1 Are unsecured creditors free to enforce their rights in each procedure?

Unsecured creditors are free to enforce their rights in each procedure, although their rights are obviously circumscribed not only by the terms of any relevant agreement, but also by the terms of the legislation in the case of a liquidation. Upon the making of a winding up order, or upon the appointment of a provisional liquidator, no actions may be commenced or continued against the company without leave of the Court. This automatic stay does not extend beyond Bermuda and if there are proceedings against the company in a jurisdiction outside Bermuda, relief in that jurisdiction would need to be sought to obtain a stay.

In the case of a Scheme of Arrangement, the rights of unsecured creditors may be varied if the scheme is approved at the meeting and sanctioned by the Court. Furthermore, in the case of a provisional liquidation (especially a soft-touch provisional liquidation), unsecured creditors' rights are essentially suspended while the provisional liquidator gathers in the company's assets and/or attempts to effect a restructuring, either by agreement with all interested parties or by way of a Scheme of Arrangement.

3.2 Can secured creditors enforce their security in each procedure?

Secured creditors can take steps to enforce their security rights in each procedure. Secured creditors have several options in respect of their security rights. They can elect to enforce their security (which essentially takes place outside the liquidation process). If the value of the security exceeds the value of the debt, the secured creditor will make a full recovery, and the balance will form part of the company's assets for distribution in the liquidation. If the value of the security is less than the value of the debt, the secured creditor will recover the value of the security, and will be able to prove and rank as an unsecured creditor for the balance of the debt owed to him. Otherwise, the secured creditor can value his security and allow the liquidator to realise it for him, or can simply relinquish his security and seek to prove in the liquidation as an unsecured creditor.

3.3 Can creditors set off sums owed by them to the company against amounts owed by the company to them in each procedure?

Section 37 of the Bankruptcy Act 1989 applies to companies in liquidation, and provides for mandatory set off in the event of a

liquidation in Bermuda. In particular, where there have been mutual credits, mutual debts or other mutual dealings, between a debtor company in compulsory liquidation and any other person proving or claiming to prove a debt in the liquidation, 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. However, 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 insolvency 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 crystallised 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 (i.e. the parties giving rise to the debt are identical to the parties giving rise to the credit, and the parties have contracted with each other in the same capacity).

4 Continuing the Business

4.1 Who controls the company in each procedure? In particular, please describe briefly the effect of the procedures on directors and shareholders.

Compulsory liquidation: the liquidator or provisional liquidator appointed by the Court controls the procedure of liquidation, and displaces the company's board of directors upon his appointment. The exercise by the liquidator of his powers is subject to the sanction, supervision and control of the Court, and, to a lesser extent, the Committee of Inspection, if one is appointed. In the same way as the board of directors is displaced, so too are the powers of the shareholders displaced.

Soft touch provisional liquidation: subject to the circumstances of the case, the Court can order that a provisional liquidator be appointed with limited powers (i.e. a 'soft touch'), and that the directors continue to retain all of their powers or certain limited powers, subject only to the supervisory role to be played by the provisional liquidator. This can be an important tool for the purposes of effecting a restructuring, especially in the context of international insolvencies which require parallel restructuring procedures both in Bermuda and in other jurisdictions.

Voluntary liquidation: the liquidator appointed by the company's members and/or creditors controls the procedure of voluntary liquidation. The board of directors is displaced upon the appointment of the liquidator, and their powers are terminated.

Scheme of Arrangement: if a Scheme of Arrangement is conducted within a liquidation, the liquidator controls the process. If the Scheme of Arrangement is conducted outside a liquidation, the company's board of directors and any managers control the process, although a Scheme Administrator is normally appointed to administer the scheme once it is implemented.

4.2 How does the company finance these procedures?

The company generally uses its own assets to finance the procedures of voluntary liquidation, compulsory liquidation, and any Scheme of Arrangement. However, if the company does not have sufficient assets or liquidity, it is possible for the company, or its liquidators, to enter into funding arrangements with those interested in the outcome of the

procedures, typically creditors, if doing so is necessary for the beneficial winding up of the company. In such a case, funding liabilities would be expected to be re-paid by the company or by the liquidator prior to the repayment of unsecured creditors, although subject to the specific terms of any funding agreement. In certain cases, the liquidator appointed by the Court is the Official Receiver, being a government official with a limited government budget.

4.3 What is the effect of each procedure on employees?

In the case of a compulsory liquidation or a creditors' voluntary liquidation, employment contracts are terminated. Employees that are located in Bermuda will receive payment of their contractual entitlements in priority to other creditors, pursuant to section 33(3) of the Employment Act 2000. Employees of a Bermuda company located outside of Bermuda are entitled to payment of up to \$2,500 in unpaid salary and holiday pay, under section 236(2) of the Companies Act 1981.

In the case of a 'soft touch' provisional liquidation, employees may or may not be retained, depending on the circumstances in which any proposed restructuring is effected.

In the case of a Scheme of Arrangement, employees may or may not be retained, depending on the circumstances in which any proposed Scheme of Arrangement is effected.

4.4 What effect does the commencement of any procedure have on contracts with the company and can the company terminate contracts during each procedure?

Section 33(1) and 33(2) of the Employment Act 2000 provide that the winding up or insolvency of an employer's business shall cause the contract of employment of an employee to terminate one month from the date of winding up or the appointment of a receiver, unless, notwithstanding the winding up or insolvency, the business continues to operate.

Otherwise, as a matter of law, there is no automatic termination of contracts with the company upon the commencement of a compulsory liquidation or a creditors' voluntary liquidation (save in the case of the liquidator disclaiming an onerous contract or transaction, and save in the case where the relevant contract contains contractual terms to that effect). However, a contracting counterparty can only claim in the liquidation for debts which exist at the date of commencement of the liquidation, and interest also ceases to run from that date. In the circumstances, there is, as a matter of fact, a termination or cancellation of contracts in the event of liquidation, unless the liquidator elects to affirm the relevant contract. Contracting counterparties can also seek to assert claims against the company for damages sustained as a result of any breach of contract caused by the commencement of the liquidation, subject to proof in the liquidation.

The commencement of a Scheme of Arrangement has no automatic effect on contracts, save in the case where the relevant contract contains contractual terms to that effect. If a Scheme of Arrangement with creditors is approved, the scheme will govern any issues relating to the termination of contracts with those creditors.

5 Claims

5.1 Broadly, how do creditors claim amounts owed to them in each procedure?

Unsecured creditors file a proof of debt or proof of claim, with any supporting material and documents, with the liquidator, company,

or the Scheme Administrator by any relevant deadline that might be set. The Court may give directions that proofs of debt be dispensed with in certain circumstances (Rule 64 of the Companies (Winding-Up) Rules 1982).

5.2 What is the ranking of claims in each procedure? In particular, do any specific types of claim have preferential status?

In a compulsory liquidation or a creditors' voluntary liquidation, creditors' claims are ranked in the following order:

1. secured creditors enforce their security outside the liquidation, but essentially in priority to all other creditors;
2. the costs and expenses of the liquidation, including all costs, charges and expenses properly incurred in the company's winding up, including liquidator's remuneration if sanctioned by the Court (pursuant to sections 194, 232, and 236(6) of the Companies Act 1981 and Rule 140 of the Companies (Winding-Up) Rules 1982);
3. debts due to employees located in Bermuda under section 33(3) of the Employment Act 2000;
4. preferential debts owed to preferential creditors pursuant to section 236(1) of the Companies Act 1981, including unpaid taxes under the Taxes Management Act 1976, unpaid contributions to occupational pension schemes under the Contributory Pensions Act 1970, liability for compensation under the Workmen's Compensation Act 1965, and payments of up to \$2,500 due to employees of Bermudian companies but resident outside of Bermuda;
5. debts secured by a floating charge (although higher priority debts must be paid out of any property secured by a floating charge if the assets of the company are not otherwise sufficient to meet them pursuant to section 236(5) of the Companies Act 1981);
6. unsecured creditors' debts, including the unsecured balance of secured creditors' claims (pursuant to sections 158(g), 225 and 235 of the Companies Act 1981);
7. post-liquidation interest on unsecured creditors' debt claims;
8. debts due to shareholders in their capacity as such (pursuant to section 158(g) of the Companies Act 1981); and
9. shareholders' equity in the event of a surplus balance, according to their rights and interests under the company's bye-laws.

Each category of debts must be paid in full before payment of creditors in the subsequent category. Creditors in the same category rank equally (or *pari passu*) among themselves.

However, in the case of the winding up of segregated accounts companies, section 25 of the Segregated Accounts Companies Act 2000 provides that the liquidator shall deal with the assets and liabilities which are linked to each segregated account only in accordance with the segregation principles of the legislation and the relevant governing instruments or contracts for each transaction. Section 36 of the Insurance Act 1978 also provides that, in the case of an insurer carrying on long-term business, the assets in the insurer's long-term business fund will only be available for meeting the liabilities of the insurer attributable to its long-term business, and its other assets shall only be available for meeting its other liabilities.

There is some scope for argument as to the order of priority for payment of claims asserted by former shareholders in mutual fund companies, whose shares have been redeemed but who are owed payment of the redemption proceeds at the commencement of liquidation. The general view is that these are debts due to shareholders that rank behind outside trade creditors' debts, but

ahead of shareholders' equity, but the legislative provisions, including section 158(g) of the Companies Act 1981, are not entirely clear in this respect, notwithstanding a recent judgment of the Supreme Court of Bermuda that has touched upon the issue.

In the event of a Scheme of Arrangement, the ranking of claims will depend on the terms of the scheme.

5.3 Are tax liabilities incurred during each procedure?

No particular tax liabilities are incurred in each procedure. Stamp duty is payable in the ordinary way, save that section 253 of the Companies Act 1981 provides various exemptions from stamp duty where a company is in compulsory liquidation or creditors' voluntary liquidation.

6 Ending the Formal Procedure

6.1 What happens at the end of each procedure?

In the course of the liquidation, the liquidator will adjudicate the claims of unsecured creditors and collect the assets of the company. Assets will be distributed (to the extent available) according to the statutory priorities in the form of dividends. At the end of this process, the liquidator is generally released, and the company dissolved.

Following Court approval of a Scheme of Arrangement (see below), the scheme is implemented under the auspices of the company's directors and the Scheme Administrator (or the liquidator, if one has been appointed). The company may continue in all respects (subject to the scheme) as before. Alternatively, where the scheme was promoted in the context of winding up proceedings, the liquidation of the company may proceed on the basis of the balance of its assets and liabilities.

7 Restructuring

7.1 Is a formal procedure available to achieve a restructuring of the company's debts in Bermuda?

As above, the general purpose of liquidation is to gather in, and realise assets, to pay off creditors in accordance with their rights and priorities, and to distribute any remaining assets to the company's shareholders.

A Scheme of Arrangement is a formal procedure which may be used to reorganise the business of the debtor with a view to its continued trading.

A scheme may result in the adjustment or compromise of all or a class of the debt of the company. It may include the transfer of rights, property and liabilities of the company to another company. The Court has jurisdiction to make specific provision for this in the order sanctioning the scheme.

A scheme is not an intrinsically insolvency-related procedure. However, it may be employed after appointment of a liquidator or provisional liquidator, and there can be advantages in employing a scheme in this way. Where illiquidity issues confront the company, for example, its freedom to promulgate or pursue a Scheme of Arrangement may be susceptible to litigation or compulsory winding-up petitions presented by dissentient creditors. Where this is a concern, the powers of the Court pertaining to the winding up of companies and appointment of liquidators may be employed in the protection of a proposed scheme.

Following presentation of a petition for the winding up of the company, a provisional liquidator may be appointed who may then apply for statutory stay of proceedings while the scheme process continues. This method is discussed above in response to question 4.1 under the heading "Soft-touch provisional liquidation". While the scheme is promulgated, voted upon and submitted to the Court for approval, the winding-up hearing remains adjourned (although the company enjoys the protection of the statutory moratorium). Upon the scheme's taking effect, the petition is dismissed with no winding-up order made.

The Scheme of Arrangement procedure may be initiated by application of a creditor, a member, the company itself, or (where one has been appointed) the liquidator.

The applicant requests the Court to convene a meeting of the creditors, or the relevant class of creditors, of the company. If the Court so directs (which will almost always be the case), creditors must be summoned by notice. Notification commonly includes advertisement of the meeting.

Where, because of differences in their respective rights, two or more creditors are unable to consult together with a view to their common interest, it will be necessary to separate creditors into classes for the purposes of voting on the scheme proposal.

If a majority within each class of creditors present and voting (including by proxy) at the meeting, representing 75 per cent by value of that class, votes in favour of the scheme, and the Court approves it, then the scheme will be binding on all creditors.

Court approval is a discretionary matter. The Court must be satisfied that the statutory requirements have been met, including the holding of requisite class meetings and approval of necessary majorities, and that each class was fairly represented at each meeting. In addition, the Court must be satisfied that the scheme is fair to creditors generally – in other words, that the majority has not taken unfair advantage of its position.

The scheme is not effective until a copy of the sanction order is delivered to the Registrar of Companies. The scheme order must be annexed to any copies of the company's memorandum of association issued subsequent to the order.

In the case of an insolvent insurance company, there is another restructuring tool potentially available under section 37(5) and section 39 of the Insurance Act 1978. These provisions enable the Court, if it thinks fit, to reduce the amount of the insurance contracts of the insurer, on such terms and subject to such conditions as the Court thinks fit. Although the procedure and case law in this area is not fully developed in Bermuda, it is likely that the Court would require that a meeting of policyholders be convened, and their views canvassed, and one relevant consideration for the Court would be the effect of any reduction order on the company's ability to make recoveries against its reinsurers. Depending on the circumstances, a formal Scheme of Arrangement may be required in any event.

7.2 If such a procedure is available, is a debt for equity swap possible and how are existing shareholders dealt with?

A debt for equity swap can, in principle, take place in Bermuda, in circumstances where a lender agrees to reduce the amount of debt that it is owed by the borrower, by agreeing to subscribe for new shares or other equity interests in the borrower equal to the value of the reduction of the debt.

The borrower issues new shares to the lender (thereby increasing the total number of shares in issue in the borrower and potentially diluting the value of, or subordinating the interests associated with,

existing shareholders' equity interests), and the outstanding debt is either reduced or eliminated depending on the agreed level of swap.

Ordinarily, but subject to the terms of the relevant company's by-laws, a debt for equity swap would require the approval of the company's other creditors (if any) and the approval of its existing shareholders, given the requirements for fresh share issues and allotments, creation of a new share classes, amendments to the by-laws, and disapplication of shareholders' rights of pre-emption.

Various regulatory requirements will also need to be satisfied to enable the creditor to take shares in the debtor company.

The implementation of a debt for equity swap must also not be unfairly prejudicial to minority shareholders, although, in the event of minority dissent, it may be possible to effect a debt for equity swap, with the sanction of the Court, through a Scheme of Arrangement.

7.3 Can dissenting creditors be crammed down?

Absent insolvency, nothing prevents a debtor and creditor agreeing to the restructuring of individual obligations, and nothing prevents a debtor from seeking to reach an agreement out of court with all of its creditors, on a unanimous basis. Indeed, renegotiations of this kind are common.

Where it is sought to restructure all, or a substantial quantity, of the company's obligations, in the absence of unanimous creditor consent, it may be necessary to "cram down" dissentient creditors. The only way of effecting a restructuring in the face of opposition from dissenting creditors is through a Scheme of Arrangement. This involves a limited formal procedure, but it need not involve insolvency-related protection.

As discussed in question 7.2 above, much will depend on the organisation of creditors into appropriate voting classes. If a majority within each class of creditors present and voting (including by proxy) at the meeting, representing 75 per cent by value of that class, votes in favour of the scheme, and the Court approves it, then the scheme will be binding on all creditors.

7.4 Is consent needed from other stakeholders for a restructuring?

If a proposed Scheme of Arrangement only affects the rights of a company's creditors (in the event of insolvency, for example), then it may not be necessary to promote a Scheme of Arrangement with the company's shareholders or contributories. However, parallel schemes may need to be promoted with both the company's creditors and with the company's shareholders, in the event that the company is solvent, and the proposed debt restructuring has a significant impact on the rights of shareholders.

In certain circumstances, it may be necessary to secure regulatory consent to a proposed restructuring from the relevant regulatory authorities in Bermuda, such as the Registrar of Companies and the Bermuda Monetary Authority.

8 International

8.1 What would be the approach in Bermuda to recognising a procedure started in another jurisdiction?

Bermuda has no statutory equivalent of Chapter 15 of the US's Bankruptcy Code, section 426 of the UK's Insolvency Act 1986, or the UK's Cross-Border Insolvency Regulations 2006, by which the UK implemented the United Nations Commission on International Trade Law's Model Law on Cross-Border Insolvency. The Supreme Court of Bermuda has nonetheless confirmed, following the Privy Council decision in *Cambridge Gas Transportation Corp v Navigator Holdings plc* [2007] 1 AC 508 that, as a matter of common law, the Supreme Court of Bermuda may (and usually does) recognise liquidators appointed by the Court of the company's domicile and the effects of a winding up order made by that 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.

However, the precise scope of Bermudian Courts' common law power to assist foreign liquidations, and, in particular, to "provide assistance by doing whatever it could have done in the case of a domestic insolvency" has been the subject of considerable debate in a number of recent judgments, including in two recent judgments by the Court of Appeal for Bermuda. In summary, subject to the facts of any particular case and the outcome of any further appeal to the Privy Council, the Bermuda Court is likely to recognise the winding up orders of foreign Courts, and to assist foreign liquidators to the fullest extent possible, in circumstances where:

1. there is a "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;
2. 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
3. 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).

There is some uncertainty as to whether a foreign Scheme of Arrangement or related procedure (such as an insurance business transfer scheme under legislation implementing European single market insurance directives) can be recognised and enforced in Bermuda as a matter of common law. Although the Supreme Court of Bermuda has shown some willingness to recognise foreign Court orders approving foreign schemes (in the absence of opposition), it is unclear what position it might take in a contentious situation.

**Alex Potts**

Sedgwick Chudleigh Ltd.
E.W. Pearman Building
20 Brunswick Street
Hamilton HM10
Bermuda

Tel: +1 441 296 9276
Fax: +1 441 296 9277
Email: alex.potts@sedgwicklaw.com
URL: www.sedgwick-chudleigh.com

Alex Potts has a wide-ranging commercial litigation and arbitration practice, with a focus on disputes in the fields of contentious insolvency, banking, financial services, investment funds, insurance, reinsurance, professional negligence, aircraft finance, company law, and trusts.

Mr. Potts has conducted cases and appeared as counsel before a variety of courts and tribunals, in England and Wales, Bermuda and the Cayman Islands, representing creditors, directors, managers, liquidators, and debtors.

Mr. Potts' recent reported insolvency cases include: *Phoenix Global and Phoenix Capital v Citigroup & Bank of Bermuda* [2007] Bda LR 61, [2009] Bda LR 68, [2009] Bda LR 70; *In the matter of Stewardship Credit Arbitrage Fund Ltd* [2008] Bda LR 67; *Saad Investments Company Limited (in Caymanian Liquidation) v Green Way Special Opportunities Fund Limited & Credit Agricole (Suisse) SA* [2010] Bda LR 83; and *In the matter of Kingate Management Limited* [2012] Bda LR 14, [2012] Bda LR 63.

Mr. Potts regularly advises, speaks and writes on issues of insolvency law in Bermuda.

Alex Potts' full professional profile is available at: www.sedgwick-chudleigh.com/people/potts_a.html.

**Nick Miles**

Sedgwick Chudleigh Ltd.
E.W. Pearman Building
20 Brunswick Street
Hamilton HM10
Bermuda

Tel: +1 441 296 9276
Fax: +1 441 296 9277
Email: nick.miles@sedgwicklaw.com
URL: www.sedgwick-chudleigh.com

Nick Miles is a commercial insurance lawyer specialising in a broad range of contentious and non-contentious matters, reorganisations and regulatory matters.

Mr. Miles advises clients on corporate, commercial and insurance matters, including: corporate insolvency; directors' powers/duties and shareholder disputes; Bermuda captive insurers and segregated accounts companies; winding-up and dissolution of companies; and schemes of arrangement. In his insolvency practice, he advises Liquidators and Administrators of companies and funds and creditors in relation to creditor and contributory compulsory winding-up petitions, the implications of English and Bermuda insolvency law and procedure in relation to the taking of security over assets to collateralise commercial obligations, and business transfers.

Mr. Miles also represents insurers and reinsurers in complex, multi-jurisdictional litigation and arbitration, often concerning captive structures, alternative risk transfer products, and long-tail exposure such as asbestos pollution and health risks. He has handled arbitration proceedings on behalf of monoline insurers relating to ISDA credit default swaps.

Nick Miles' full professional profile is available at: www.sedgwick-chudleigh.com/people/miles_n.html.

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59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: sales@glgroup.co.uk

www.iclg.co.uk