



## Members' voluntary winding-up as a corporate governance tool

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**Companies do not cease to exist when they become non-operational or stop trading; good sense and best practice require that companies that are no longer needed should be properly wound up as spelled out in law.**

A company is a legal entity or person. Like a human being, a company can reach the end of its lifespan for various reasons, even when such an entity can fully meet its obligations as and when they fall due, i.e., fully solvent. The most obvious reason for such an occurrence is when a company set up to accomplish a particular purpose has attained that purpose and, therefore, it is no longer required. Such companies are common in the offshore economy as they provide a means for disparate parties, e.g., investors from different onshore jurisdictions, to pool capital into a neutral agency meant to facilitate investments, manage risks, or serve other purposes. Corporate mergers and acquisitions also often result in some dormant companies within the emerging corporate group that are not needed.

The existence of loose, no longer required, or ill-defined companies within a corporate group can undermine corporate governance. One may argue that this matter is of little concern for well-established corporates that are adequately capitalized and have little risk of becoming insolvent. In our experience, this mindset can stymie corporate actions when time is of the essence. For instance, we have observed cases where the delay in making final distributions to shareholders is due to the need to wind down non-operational and no longer required subsidiaries. This does not take into account other statutory and operational requirements like the preparation of financial statements, filing of records with regulators or registrars, maintenance of registered offices, and such other paraphernalia required of a legally existing entity, activities which, looked at cumulatively over time, could be significantly costly as compared to a timely wind-down.

### **What is a member's voluntary winding up?**

A members' voluntary winding-up, commonly referred to as a Members' Voluntary Liquidation (MVL), is a legal mechanism available to a company's shareholders when they want to close a solvent company. The shareholders and the directors of a company drive an MVL process. In Bermuda, the circumstances in which a company may be wound up voluntarily are set out in Sections 201 and 202 of the Companies Act 1981.

### **Why are corporates hesitant to initiate MVLs?**

In our experience, reputational concerns are the foremost reason those charged with corporate governance hesitate to initiate MVLs to close redundant subsidiaries or companies within a corporate group. They worry about the term 'liquidation' and their corporate name appearing in the same script due to the notices required to be made public when winding up a company. Often, these fears are exaggerated, leading to the decision to wind up redundant companies within a corporate group being kicked down the road until there is no more road. While there are alternatives to an MVL depending on the jurisdiction, an MVL is perhaps the cleanest and most conclusive mechanism for closing solvent companies within a corporate group.

### **Legal, procedural, and practical considerations**

#### ***Declaration of solvency***

A declaration of solvency, sworn by a majority of directors, effectively initiates the process for a member's voluntary winding-up. In the statutory declaration, the directors state that the company will be able to pay its debts in full (plus interest where applicable) within twelve months from the commencement of the winding up. A declaration of solvency contains either a statement of the company's assets and liabilities at the last practicable date before the making of the declaration or a statement to the effect that the opinion of the directors was based on an indemnity, undertaking, or pledge made in favor of the company in respect of its liabilities<sup>[1]</sup>. A declaration of solvency should be made within five weeks immediately preceding the date of the passing of the resolution for voluntarily winding up<sup>[2]</sup> (in a general meeting of the company). It should be filed with the Registrar of Companies before that date.

#### ***Notices and meetings***

An MVL involves the issuance of various notices and the passing of specific resolutions. The proposed liquidator and or legal advisors can guide these processes. In practice, consideration should be given to a company's bylaws concerning the calling and quorum of meetings - where possible, written resolutions can be drawn, hence avoiding the need to hold actual meetings. An MVL commences when shareholders pass resolutions

that the company be wound up voluntarily and appoint a Liquidator<sup>[3]</sup>.

### Cross border considerations

Sometimes, a winding up may be in relation to a holding company. For instance, we have supported liquidating Bermuda-registered entities with subsidiaries in multiple onshore jurisdictions. Such a scenario calls for adequate in-advance planning to ensure that the liquidation of the holding company is not delayed by the sale, transfer, or liquidation of its subsidiaries. It is also important to consider the treatment of intra-group balances and any tax considerations.

### Cost

The cost of an MVL depends on the extent of the affairs that need to be wound up. An MVL is a reasonably affordable process, especially in cases where most of the company's affairs are dealt with before a liquidator is appointed. It is common to agree to a fixed fee arrangement in an MVL.

In our experience, we have seen situations where delayed action to initiate an MVL process and embark on an orderly and timely wind-down has resulted in a compulsory wind-down process, which is generally costlier and prone to dissipating a company's assets.

### Conclusion

Good corporate governance is a direct responsibility of the Board of Directors. Directors must be adequately aware of the status of the various companies within a corporate group and, where necessary, take steps to close no longer-needed entities. Directors should make it apparent to relevant stakeholders, such as management and corporate service providers, that no longer required or ill-defined companies within a corporate group should be promptly wound up.

### Footnotes

[1] Companies Act 1981 - Section 206(2)(b) | [2] Companies Act 1981 - Section 206(2)(a) | [3] Companies Act 1981 - Section 208

### Timelines and dissolution

A straightforward MVL can be completed within a three to six-month timeframe. Adequate upfront planning with the proposed liquidator can ensure that any thorny issues are resolved before a company is placed into the MVL process. Once the return of the final meeting and other required documents have been delivered to the Registrar of Companies, a Certificate of Dissolution is usually issued in about three months. A company is considered dissolved with effect from the final meeting date.

### Other issues

- On appointment, a liquidator could require an indemnity from the company's beneficial owners for the liabilities, costs, claims, demands, proceedings, charges, expenses, etc., arising from the liquidation. However, alternative solutions can be considered with the proposed liquidator, depending on the company's situation.
- The objective of a liquidator in an MVL is to realize the company's assets, settle all the expenses of the liquidation and the company's liabilities, and return any surplus assets to the company's shareholders.
- Section 35A of the Insurance Act 1978 provides that an insurer carrying on a long-term business shall not be wound up voluntarily. In liquidating other insurance companies, some considerations, such as deregistration with the Bermuda Monetary Authority, should be discussed with the proposed liquidator.



#### About the author

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