Norton Rose Fulbright

International Restructuring Newswire

A quarterly newsletter from the bankruptcy, financial restructuring and insolvency team at Norton Rose Fulbright

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To our clients and friends:

To our clients and friends:

As we go to press, the war in Ukraine continues. Russia is unrelenting in continuing its brutal military campaign that has left cities in ruin and forced millions to flee their homes. Here at Norton Rose Fulbright we stand unequivocally behind the people of Ukraine and have made the decision to wind down our operations in Russia and to close our Moscow office.

Putin's war against Ukraine has created a whole new set of risks for the global economy that was already facing challenges created by the deadly COVID-19 pandemic. The pandemic impaired global supply chains and led to soaring transport costs. Now, disruptions from the war are stoking global inflation, with soaring prices for oil and food and rising interest rates. This has led forecasters to sharply lower their estimates of economic growth this year. William Dudley, a former president of the Federal Reserve Bank of New York, has gone so far as to suggest that a recession is "virtually inevitable." Whether Dudley is correct remains to be seen—economists are notoriously terrible at predicting recessions.

With such global instability, those of us in the restructuring community would be well advised to stay current on all of the recent developments and changes in the restructuring environment around the world. In this issue, my colleagues from the United States, Singapore, Canada, Australia, Italy and the Netherlands provide you with these critical updates.

Stay well,

Howard Seife
Global Head
Bankruptcy, Financial Restructuring and Insolvency

In the news

Law360 bankruptcy group of the year

Norton Rose Fulbright's US bankruptcy, financial restructuring and insolvency group has been named a 2021 “Practice Group of the Year” in the bankruptcy category by Law360. The annual awards honor the law firms behind the litigation wins and major deals that resonated throughout the legal industry in the past year.

GRR ‘40 under 40 2022’ list

Omar Salah, head of Amsterdam’s financial restructuring and insolvency group, has been included in this year’s Global Restructuring Review (GRR) '40 Under 40 2022' list. The annual list is GRR’s selection of global restructuring specialists and leading individuals in the sector under the age of 40, aiming to identify the ‘next generation of rising stars within the cross-border restructuring community.’

Eric Daucher, head of New York’s financial restructuring and insolvency group, was also given a special mention, having been identified as one of ten additional noteworthy restructuring professionals.

Omar Salah appointed as Conferee of CERIL

Omar Salah has been appointed as Conferee of the Conference on European Restructuring and Insolvency Law (CERIL). CERIL is a non-profit organisation with a unique independent perspective on developments in restructuring and insolvency systems across Europe. It is an invitation-only membership organisation of experienced and respected restructuring and insolvency practitioners, judges and academics.

INSOL International

Tiziana Del Prete was one of five lawyers invited to join the INSOL Main Organising Committee in connection with INSOL’s global conference in London being held June 26-28, 2022. The conference coincides with the 40th Anniversary of INSOL International.

Omar Salah appointed as expert to the P.R.I.M.E. Finance Panel of Experts

Omar Salah has been appointed as expert to the P.R.I.M.E. Finance Panel of Experts. P.R.I.M.E. Finance stands for the Panel of Recognised International Market Experts in Finance, an innovative collaboration launched in January 2012, and established to help resolve, and to assist judicial systems in the resolution of, disputes concerning complex financial products. P.R.I.M.E. Finance has the support of key international regulatory bodies and is complementary to the financial market regulatory reforms implemented after the global financial crisis in 2008.

Eight US lawyers named to Lawdragon’s bankruptcy and restructuring list

Jason Boland, Eric Daucher, Toby Gerber, Kristian Gluck, Bill Greendyke, Ryan Manns, David Rosenzweig and Howard Seife were listed in this year’s Lawdragon 500 Leading US Bankruptcy and Restructuring Lawyers in America.

California CLE Blitz

January 25-26, 2021

Rebecca Winthrop spoke on a panel on unconscious and conscious bias at Norton Rose Fulbright's January CLE Blitz. The panel discussed practical considerations and impediments from bias in the courtroom, during arbitrations or in mediations.

INSOL International – Latin America Virtual Seminar

March 3, 10, 17, 2022

Howard Seife chaired INSOL's Latin America Virtual Seminar in March. Program topics included International Dispute Funding in Latin America, Sovereign Debt in Latin America and Latin American Debtors Seeking Protection in the US Bankruptcy Courts.

Omar Salah writes annotation of Dutch scheme (WHOA) case law

Omar Salah was invited to write an annotation on the court order on the Dutch scheme (Wet homologatie onderhands akkoord, WHOA) on the largest restructuring under the WHOA so far. The annotation is for JOR with case law reference JOR 2022/103. JOR is a leading law review on insolvency law and corporate law in the Netherlands.

Global Perspectives Podcast features Omar Salah on the WHOA

Omar Salah participated in a recent episode of International Insolvency Institute's *Global Perspectives* podcast. The discussion focused on the

"Dutch Scheme" or "WHOA" (Wet Homologatie Onderhands Akkoord) – the reasons for the enactment of the WHOA, its key features, and recent WHOA proceedings.

Recent case law developments in Singapore's restructuring and insolvency laws show balancing between pro-rehabilitation policies and pro-creditor policies

Kei-Jin Chew and Clare Lee

Singapore continues to develop its status as an upcoming international hub for debt restructuring. The nation-state updated and strengthened its restructuring and insolvency laws in recent years, primarily through enacting the omnibus Insolvency, Restructuring and Dissolution Act 2018 (IRDA) and incorporating the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) into Singapore law.

The Singapore courts have also rendered recent decisions that strike a balance between strengthening pro-cross border reorganisation goals and adhering to the creditor-friendly history of Singapore law.

This article provides a brief survey of certain significant decisions in Singapore relating to rescue lending, restructuring and winding up.

Court of Appeal provides important clarification on the Model Law: The remedies under the Model Law depend on remedies available in the equivalent Singapore insolvency proceeding

In *United Securities Sdn Bhd (in receivership and liquidation) v. United Overseas Bank Ltd* [2021] SGCA 78, the Singapore Court of Appeal provided two key clarifications on the Model Law (as incorporated into Singapore law by IRDA).

The Court of Appeal essentially held that it would only grant such a stay under the Model Law if a stay would have been available in the equivalent Singapore insolvency proceeding. This potentially impacts a company's ability to seek a stay in Singapore for support of a foreign insolvency under the Model Law.

Briefly, a winding up order had been made against United Securities Sdn Bhd (in receivership and liquidation) (USSB) in Malaysia. United Overseas Bank Ltd (UOB), a secured creditor of USSB, however, commenced an action in Singapore to enforce its security against USSB (the Singapore Proceedings).

USSB took out an application in the Singapore court for recognition of the Malaysian winding up proceedings as a "foreign main proceeding". USSB also sought a stay of the Singapore Proceedings under Article 20 of the Model Law.

The Singapore Court of Appeal provided clarification on the scope of a stay or suspension upon the recognition of a "foreign main proceeding". The court held that the ambit of any stay or suspension arising from Article 20(1) is limited to what would have been available under Singapore law had the debtor company been wound up in Singapore. A stay of the Singapore Proceedings would not have been available under Singapore law had USSB been wound up in Singapore, as secured creditors would readily be granted leave to enforce their security in a winding up. Accordingly, a stay would also not be granted under Article 20 of the Model Law.

USSB had also commenced a writ action against, *inter alia*, UOB in Malaysia (the Malaysian Writ Action). The issue of whether the Singapore Proceedings ought to be stayed under the Model Law in recognition of the Malaysian Writ Action as a "foreign proceeding" had, for various reasons, become moot, but the Singapore Court of Appeal dealt with it anyway. On this, the Court of Appeal expressed the view that the Malaysian Writ Action was not a "foreign proceeding" within the meaning of Article 2(h) of the Model Law for several reasons. First, it was not "a collective proceeding". It did not contemplate the consideration and eventual treatment of the rights, obligations and claims of USSB's creditors generally. Second, it did not have a basis in the law relating to insolvency. Third, the Malaysian Writ Action did not involve the Malaysian High Court's control of or supervision of USSB's property and affairs. Fourth, the purpose of the Malaysian Writ Action was not USSB's re-organisation or liquidation, but was instead to determine the parties' rights, liabilities and obligations. The significance of this finding is that it lay out the requisite attributes for a proceeding to be "a foreign proceeding" under the Model Law in Singapore.

Super priority granted to "roll-up" rescue financing for the first time: A pro-reorganisation move for both debtors and secured lenders

In *Re Design Studio Group Ltd* [2020] SGHC 148, for the first time, the High Court approved a "roll-up" rescue-financing package and granted super-priority over the rescue finance.

A "roll-up" is when new funds are injected by a financier into a company post-petition to pay off some or all of the lender's pre-existing debt such that the pre-existing debt is effectively "rolled-up" into the super-priority post-petition debt owing to the financier.

The question before the court was whether a bank could inject fresh funds into a company (that had obtained a moratorium on its debts for the purposes proposing a scheme of arrangement to its creditors) to pay off the bank's pre-existing debts and have that injection of funds treated as rescue financing (i.e. a "roll-up") and be given super-priority.

The court found in *Re Design Studio Group Ltd* that the statutory provision providing for super-priority for rescue financing (now s 67 of IRDA) was broad enough to encompass "roll-ups". This was because "roll-ups" constitute a form of financing as long as they are necessary for the survival of the company as a going concern or necessary for a more advantageous realization of its assets compared to a winding up. There was nothing in the language of the statutory provision that prohibited a rescue financier from stipulating condition in the grant of its rescue finance, and there was no legislative intent to prohibit all "roll-ups" from constituting rescue financing.

In short, the court held that there was no general prohibition of "roll-ups", and "roll-ups" can constitute rescue financing provided they meet the requirement of what constitutes rescue financing.

The court also provided guidance on how it would exercise discretion to grant super-priority to "roll-ups", which involve a pre-existing lender leapfrogging over other creditors to get to the front of the queue for assets upon liquidation, with possibly no or little benefit to the rest of the creditor body. The court, therefore, would especially consider the extent to which unsecured creditors are likely to benefit or be prejudiced if super-priority were to be permitted. Special note would also be given to the interests of specific creditors who were previously prioritised equally or above the pre-petition debt, but would now be prioritised below or equal to the post-petition debt.

This is a significant decision for Singapore as it paves the way for "roll-up" rescue financings to feature more prominently in Singapore's restructuring landscape and will be a welcome development for lenders and distressed companies alike.

The cash flow test is the sole and determinative test for deemed insolvency: A gating issue for launching a proceeding is simplified

In *Sun Electric Power Pte Ltd v. RCMA Asia Pte Ltd* [2021] SGCA 60, the Court of Appeal clarified that the cash flow test is the only test for deemed insolvency under s 254(c) of the Companies Act (now re-enacted in s 125(2)(c) of IRDA).

The provision states that a company shall be deemed to be unable to pay its debts if "*it is proved to the satisfaction of the Court that the company is unable to pay its debts; and 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*".

The Court of Appeal held that the cash flow test should be the "sole and determinative test" for deemed insolvency under s 254(c) of the Companies Act / s 125(2)(c) of IRDA and that the balance sheet test was inapplicable.

In reaching its conclusion, the court favored the plain wording of the provision and comparative case law and found that Parliament could not have intended the balance sheet test to apply as it would not be a good indicator of the company's present ability to pay its debts. It also noted that, in the case of personal bankruptcy, there was an express provision that the balance sheet test was applicable (together with the cash flow test), whereas there was no such express provision in the case of corporate insolvency.

It was reasonable, therefore, to conclude that it was not the legislative intention to include the balance sheet test in corporate insolvencies.

The court elaborated on the cash flow test, which assesses whether the company's current assets (meaning assets realisable within 12 months) exceed its current liabilities (meaning debts which will fall due within 12 months) such that the company is able to meet all debts as and when they fall due. The court also gave guidance on factors that should be considered under the cash flow test:

- the quantum of all debts which are due or will be due in the reasonably near future;
- whether payment is being demanded or is likely to be demanded for those debts;
- whether the company has failed to pay any of its debts, the quantum of such debt and for how long the company has failed to pay it;
- the length of time which has passed since the commencement of the winding-up proceedings;

- the value of the company's current assets and assets which will be realisable in the reasonably near future;
- the state of the company's business, in order to determine its expected net cash flow from the business by deducting from projected future sales the cash expenses which would be necessary to generate those sales;
- any other income or payment which the company may receive in the reasonably near future; and
- arrangements between the company and prospective lenders, such as its bankers and shareholders, in order to determine whether any shortfall in liquid and realisable assets and cash flow could be made up by borrowings which would be repayable at a time later than the debts.

The Court of Appeal's affirmation of the cash flow test is significant as prior to this, the Singapore courts had taken the approach that both the balance sheet and cash flow tests were applicable. This clarification from the highest court has been long overdue and should make it easier for distressed enterprises to meet the insolvency test and enter a proceeding under Singapore's new law.

A debtor company may be wound up in exceptional cases even where there is a substantial and bona fide dispute on the debt: Creditors should still be looked after where the bad acts occur

Finally, of note are the High Court's remarks in *RCMA Asia Pte Ltd v. Sun Electric Power Pte Ltd* [2020] SGHC 205 (which was unsuccessfully appealed in the *Sun Electric* appeal decision discussed above). The court expressed, albeit in non-binding terms, that winding up can be ordered at the request of a creditor in exceptional cases, even if there was a substantial and *bona fide* dispute regarding the creditor's debt.

In coming to this decision, the court favoured the English position that the dismissal of winding up petitions involving disputed debts was a rule of practice rather than a rule of law. The court opined that this approach would give flexibility to deal with exceptional cases where applying a general rule to wind up would lead to injustice.

The court's view was *obiter dicta* (i.e. not essential to its final decision), and the issue was not determined on appeal but it is nonetheless instructive of the approach that the court may take in an appropriate case in the future.

The court's comments on the facts of the case will also be of useful guidance to creditors, in particular in cases where the debtor is clearly insolvent and has carried out seriously prejudicial acts.

In *RCMA Asia*, the court was of the view that there would have been exceptional circumstances justifying the winding up even if the debt were disputed. The debtor was clearly insolvent and had itself lodged judicial management and interim judicial management applications on the basis that it was insolvent and was unable to repay its debts. Further and critically, the debtor had diminished funds that were the subject of a court-ordered injunction and this led to a serious risk that the creditor would eventually be left without a remedy if winding up were not ordered. Conversely, if the debtor were wound up, a liquidator could investigate dealings with the funds and take action in the interests of the creditors.

Conclusion

These cases represent recent significant developments in the jurisprudence relating to the restructuring and insolvency regime in Singapore. They reflect the ongoing balancing act in Singapore between its creditor-focused history and the potential shifting towards a rehabilitation-friendly regime. Stay tuned for more to come.

Kei-Jin Chew is Managing Director and Clare Lee is Associate Director in our Singapore office. Kei-Jin is a member of the firm's financial restructuring and insolvency group and Clare is a member of the firm's litigation and disputes group.

Year in review: Significant US Chapter 15 decisions in 2021

Francisco Vazquez

Chapter 15 of the United States Bankruptcy Code allows a US bankruptcy court to grant recognition to an insolvency, liquidation, bankruptcy, or debt-restructuring proceeding pending in another nation (i.e., a foreign proceeding). With the globalization of the world's economy, many foreign businesses have a significant presence in the US. Consequently, it is common for foreign debtors, trustees, liquidators, and administrators, acting as "foreign representatives," to seek relief under Chapter 15 in the US, and request orders to, among other things, enjoin litigation against the debtor, preserve a debtor's assets, and pursue claims in the US.

Mirroring the decrease in Chapter 11 filings, there were 171 new Chapter 15 cases filed in 2021 (compared to the 236 Chapter 15 cases filed in 2020). The Southern District of New York (i.e., New York City) was the preferred Chapter 15 venue with 56 filings, followed by the Southern District of Texas (i.e., Houston) with 48 filings. The Chapter 15 cases filed in 2021 were ancillary to foreign proceedings pending in: Australia, Bermuda, Brazil, British Virgin Islands, Canada, Cayman Islands, Czech Republic, Dominica, Germany, Guernsey, Indonesia, Israel, Japan, Norway, People's Republic of China, Russia, Singapore, South Africa, Sweden, United Kingdom, and Uruguay.

This "year in review" article focuses on some of the significant decisions issued by the US courts in 2021. Part I of this article begins with a discussion of a decision refusing to impose the Bankruptcy Code debtoreligibility requirements in Chapter 15. Part II examines two decisions addressing requests to enforce a foreign debt restructuring in the US. Part III discusses a foreign representative's capacity to obtain relief in a US court prior to obtaining Chapter 15 recognition. Part IV concludes with a discussion of discovery under Chapter 15.

Part I: Florida bankruptcy court refuses to impose section 109 debtor-eligibility requirement in a Chapter 15 Case

Section 1517 of the Bankruptcy Code generally provides that a foreign proceeding shall be recognized if three conditions are met. First, the proceeding must be a "foreign main proceeding" or "foreign nonmain proceeding" as defined by the Bankruptcy Code. Second, the foreign representative must be a person or body. Finally, certain procedural requirements must be satisfied. Some courts, in particular the US Court of Appeals for the Second Circuit (which includes New York), have concluded that a foreign debtor must also satisfy the general debtor-eligibility requirements set forth in the Bankruptcy Code. *See Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet*), 737 F.3d 238, 247 (2d Cir. 2013). Under section 109(a) of the Bankruptcy Code, "only a person that resides or has a domicile, a place of business, or property in the United States…may be a debtor." 11 U.S.C. § 109(a). Accordingly, New York bankruptcy courts will recognize a foreign proceeding only if the foreign representative demonstrates that the debtor has a residence, domicile, place of business, or an asset in the US.

A bankruptcy court in Florida came to a different conclusion. In the case of *In re Zawawi*, the trustees of a debtor filed a petition for recognition of a UK bankruptcy. *See In re Al Zawawi,* 634 B.R. 11, 14 (Bankr. S.D. Fla. 2021). While the debtor conceded that the trustees had satisfied the requirements of section 1517, he objected to recognition on the basis that he did not meet the debtor-eligibility requirements of section 109(a). The Florida bankruptcy court rejected that argument, concluding that section 109(a) does not apply to Chapter 15. According to the bankruptcy court, "the subject of a foreign proceeding is only a 'debtor' as that term is used in chapter 15 and is not a debtor as that term is used in § 109." Moreover, the court found that there is "clear evidence of legislative intent" that section 109 does not apply in Chapter 15. In particular, the venue statute contemplates a Chapter 15 filing for an entity that does not have assets or a place of business in the US. In addition, other sections would be "rendered duplicative and superfluous" if section 109 applied to Chapter 15.

On appeal, a Florida district court affirmed the bankruptcy court's decision earlier this year. *Zawawi v. Diss (In re Zawawi)*, No. 21-cv-894-GAP, 2022 WL 5966836 (M.D. Fla. Feb. 28, 2022). In its opinion, the district court predicted that the US Court of Appeals for the Eleventh Circuit, which covers the districts located in Alabama, Florida, and Georgia, would not follow the Second Circuit's rationale in *Barnet*. Should that occur, there would be a circuit split on the Chapter 15 recognition requirements that might then be resolved by the US Supreme Court or Congress.

Part II: Court may enforce a foreign restructuring plan under Chapter 15

Under Chapter 11 of the Bankruptcy Code, if a US court confirms a plan of liquidation or reorganization, it is binding on all creditors regardless of their vote. Numerous foreign jurisdictions similarly authorize the implementation of a plan that also is purportedly binding on all creditors. However, a foreign court's order approving such a plan is not necessarily enforceable in the US. Thus, a creditor may take actions against a debtor in the US inconsistent with a foreign plan, unless the foreign court's order approving the plan is enforceable in the US. It is well established that a US court may issue an order enforcing a debt adjustment, restructuring or liquidation plan, or similar arrangement, including a scheme of arrangement, in the US under Chapter 15. In 2021, there were two significant decisions addressing such requests.

In the first, *In re Condor Flugdienst GmbH*, 627 B.R. 366 (Bankr. N.D. Ill. 2021), an Illinois bankruptcy court entered an order under Chapter 15 recognizing the German liquidation proceeding of a commercial airline in the US. The foreign representatives then requested an order enforcing a German liquidation plan in the US. As an initial matter, the bankruptcy court concluded that it had the requisite authority to issue such an order under Chapter 15. In particular, the court concluded that it had such authority under section 1521(a) of the Bankruptcy Code, which provides that, upon recognition, a court may grant "any appropriate relief," including discovery and other relief available to a trustee with the exception of the ability to avoid certain transfers. Relief under section 1521 is subject to section 1522, which provides that a court may grant relief "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected."

According to the court, Chapter 15 does not require that the relief requested or the foreign law would yield the same outcome as what would occur in a US bankruptcy case. Instead, the court was required to balance the interests of the creditors and debtor to ensure that one group was not unfairly favored over the other. In this instance, the court was satisfied that the German process was "just, unprejudiced and not unduly inconvenient." In particular, US creditors were not treated differently than other creditors. Moreover, creditors, including US creditors, were provided with the notice required under German law. In addition, US creditors were given notice of the Chapter 15 case and had an additional opportunity to be heard. The court further found that any purported hardship to creditors by enforcing the plan in the US was outweighed by "the benefits and is necessary and appropriate in the interest of the public and international comity, is consistent with the public policy of the US and is available under the provisions of chapter 15." Accordingly, the court issued an order enforcing the German plan in the US.

Unlike the *Condor* court, in the second case, a New York bankruptcy court refused to enter an order enforcing an Indonesian plan in the US. *In re PT Bakrie Telecom Tbk*, 628 B.R. 859 (Bankr. S.D.N.Y. 2021). Following recognition of an Indonesian restructuring proceeding, the bankruptcy court considered the foreign representative's request for an order enforcing the plan in the US. According to the foreign representative, the Indonesian court order approving the plan discharged the debtor and certain nondebtors from obligations under certain notes. Hence, they proposed an order from the US court enforcing the plan that included a third-party nondebtor release of claims relating to the notes. A group of noteholders objected to the request, arguing that (1) the Indonesian plan lacked a third-party release and therefore it was inappropriate to include one in the bankruptcy court's order, and (2) they were not treated fairly in Indonesia as the Indonesian court authorized the issuer of the notes, an insider of the debtor, as opposed to the noteholders or the indenture trustee, to vote the notes.

Following its review of the plan and the Indonesian court's order approving the plan, the US bankruptcy court appeared to be comfortable that the Indonesian order was sufficiently broad to release all of the obligations under the notes, including the nondebtors' obligations. The terms of the order alone, however, was not a sufficient basis for the US court to issue its order. The court concluded it had to analyze "whether such a third-party release is appropriate when viewed through the prism of comity." According to the court, such an analysis would entail consideration of the Indonesian process and whether it satisfied "fundamental standards of procedural fairness as demonstrated by a clear and formal record." In this instance, however, there was no such clear and formal record. "Indeed, the record contains no information about how this third-party release was presented to the Indonesian court for consideration or whether any creditors were heard – or even had the ability to be heard – as to a third-party release." Moreover, the record lacked any justification by the Indonesian court for the release. Given the lack of an appropriate record, the court refused to issue an order enforcing the Indonesian plan in the US.

The court further found that the reason for the Indonesian court's decision to allow an insider to vote the noteholders' claims was not clear. The US court, however, refrained from ruling on the voting issue, noting that it was refusing to enforce the plan given its third-party release concerns.

Part III: Chapter 15 recognition may not be a prerequisite to seek relief in US litigation

Before the enactment of Chapter 15, it was well established that a foreign representative or a debtor could ask a court to dismiss or stay a lawsuit pending before it in deference to a foreign proceeding under principles of comity. Following the enactment of Chapter 15, several courts concluded that Chapter 15 recognition is a prerequisite to seeking such relief, noting, among other things, that (1) section 1509(b) of the Bankruptcy Code provides that a foreign representative may seek relief from a US court after recognition, and (2) Chapter 15 is intended to be the "exclusive door to ancillary assistance to foreign proceedings." Other courts, however, concluded that Chapter 15 recognition is not necessarily a prerequisite to seeking relief from a US court. The split continued in 2021.

Facing claims in an admiralty case before a US district court sitting in Texas, a debtor in a German insolvency proceeding filed a motion for summary judgment. *HFOTCO, LLC v. Zenia Special Maritime Enterprise*, No. H-19-3595, 2021 WL 2834687 (S.D. Tex. July 7, 2021). The debtor argued that all claims against it should be asserted against the German insolvency administrator as required under German law. Hence, the admiralty claims against it should be dismissed under principles of comity. The district court, however, concluded that Chapter 15 recognition "is a prerequisite to obtaining comity from any U.S. court with respect to foreign insolvency proceedings." Thus, the court held it was "powerless" to grant the debtor any relief until the German insolvency was recognized under Chapter 15.

Two other courts, however, came to a different conclusion last year. In *Moyal v. Münsterland Gruppe GmbH & Co. KG*, 539 F.Supp.3d 305 (S.D.N.Y. 2021), the US District Court for the Southern District of New York dismissed a breach of contract claim against a German debtor notwithstanding that the German insolvency proceeding had not been recognized under Chapter 15. According to the district court, comity requires dismissal of litigation in deference to a foreign bankruptcy so long as the foreign proceedings "are procedurally fair … and do not contravene the laws or public policy of the United States." Further, according to the court, the suggestion that a Chapter 15 case is a prerequisite to dismissal or stay of the litigation "is absurd and would fly in the face of comity principles."

Similarly, the US District Court for the Eastern District of New York allowed the liquidator of a Lebanese banking institution that was in a receivership in Lebanon to intervene in litigation without requiring the liquidator to obtain Chapter 15 recognition. *Bartlett v. Societe Generale de Banque au Liban Sal*, No. 19-cv-00007, 2021 WL 3706909 (E.D.N.Y. Aug. 6, 2021). According to the district court, Chapter 15 does not apply to all litigation in the US. Instead, it is generally limited to situations where a foreign representative wants to enforce or administer an aspect of a foreign proceeding in the US. In *Bartlett*, however, the liquidator was seeking to intervene in the US litigation to assert certain defenses, not to administer the Lebanese bankruptcy. Consequently, the liquidator did not need to obtain Chapter 15 recognition before intervening. This decision is currently on appeal to the Second Circuit Court of Appeals.

Part IV: Discovery developments

Chapter 15 authorizes a foreign representative to request orders compelling discovery from any person "concerning the debtor's assets, affairs, rights, obligations or liabilities." *See* 11 U.S.C. § 1521(a)(4). Bankruptcy courts routinely authorize discovery under Chapter 15.

In 2021, a New York bankruptcy court allowed a foreign representative of a large regional commercial airline that was in South African business rescue proceedings to obtain discovery from an original equipment manufacturer ("OEM"). *In re Comair Ltd*., No. 21-10298, 2021 WL 5312988 (Bankr. S.D.N.Y. Nov. 14, 2021). According to the airline's foreign representative, the airline had several causes of action against the OEM, but the publicly available information did not provide "a full picture" of such claims. The foreign representative filed a motion for an order for discovery from the OEM. The OEM opposed the request, arguing, among other things, that "(i) the requested discovery will not 'effectuate the purpose' of Chapter 15; (ii) the requested discovery is not necessary to

protect [the airline's] assets; and" (iii) the OEM's interests are not sufficiently protected.

The bankruptcy court disagreed. A court may grant "appropriate relief," including discovery under section 1521 of the Bankruptcy Code, if the foreign representative demonstrates that such relief is "necessary to effectuate the purpose of [Chapter 15] and to protect the assets of the debtor or the interests of the creditors." As mentioned above, relief under section 1521 is subject to section 1522, which provides that a court may grant relief only if the interests of interested entities "are sufficiently protected." In this instance, the bankruptcy court was satisfied that the requirements of section 1521 and 1522 were met.

According to the bankruptcy court, the discovery would effectuate the purpose of Chapter 15. The court first determined that the foreign representative had a duty under South African law to "investigate the company's affairs, business, property, and financial situation." The discovery requested would allow the foreign representative to discharge his duties and evaluate the potential significant claims against the OEM. Second, the discovery was necessary to protect the airline's assets, particularly its claims against the OEM. The court noted that nothing in the rescue proceeding or the rescue plan barred the foreign representative from seeking discovery, which fell within the scope of the discovery available under section 1521. Third, the court concluded that the OEM's interests were sufficiently protected. Accordingly, the court directed the parties to meet and confer to address OEM's concerns regarding the scope of the discovery request. To the extent the parties could not resolve any particular discovery dispute, the court was willing adjudicate it in the future as is the customary practice in the US. The OEM has appealed this decision.

In the US, discovery orders are generally not final and hence not subject to an appeal. The US Court of Appeals for the Eleventh Circuit confirmed that general principle in the Chapter 15 context. *Fontana v. ACFB Administração (In re Transbrasil S.A. Linhas Aéreas)*, 860 Fed. Appx. 163 (11th Cir. 2021), *cert. denied*, 2022 WL 660641 (2002). In a typical case before a court, an order is "final" when issued at the completion of the case (e.g., a judgment). In a US bankruptcy case, there will likely be many "individual controversies." Hence, a bankruptcy court order is generally final only when it disposes of a discrete dispute or issue. In *Barnet*, mentioned above in Part 1, the Second Circuit held that discovery orders under Chapter 15 are appealable.

In *Fontana*, however, the Eleventh Circuit disagreed with the *Barnet* decision. According to the Eleventh Circuit, a discovery order is generally "merely a preliminary step" and not a final order. Thus, the lower court's discovery order was not appealable and the foreign representative was allowed to proceed with its discovery. In dismissing the appeal, the Eleventh Circuit, however, noted that there may be an exception to the general rule. "If a Chapter 15 case exists solely to obtain discovery for use in a foreign bankruptcy case, then the discovery might not be 'merely a preliminary step.'" In that instance, the discovery order may be final and subject to immediate appeal. One of the discovery targets petitioned the US Supreme Court to hear an appeal of the Eleventh Circuit's decision, noting that it conflicted with the Second Circuit's ruling. The Supreme Court denied that petition.

Conclusion

Chapter 15 continues to be a resource for foreign representatives to obtain relief in the US. Notwithstanding that the US enacted Chapter 15 approximately 17 years ago, the jurisprudence continues to develop and there are some significant differences among the courts in different circuits on several important issues.

Francisco Vazquez is senior counsel in our New York office in the firm's financial restructuring and insolvency group.

The Dutch Scheme (WHOA) in practice: First two large restructuring plans confirmed by the Dutch courts

Prof. Omar Salah and Koen Durlinger

On 1 January 2021, the Act on Court Confirmation of Extrajudicial Restructuring Plan (*Wet Homologatie Onderhands Akkoord*, WHOA) entered into force. Contrary to expectations, the first year of the WHOA has been marked by restructurings of small and medium-sized enterprises (SME).[1] At the end of 2021, approximately 150 restructurings under the WHOA were pending, 90 court orders had been published under the WHOA and 16 of these court orders related to the confirmation of a restructuring plan under the WHOA.

We have now seen the successful use of the Dutch scheme for larger restructurings as well. In late 2021 and early 2022, restructuring plans in two large WHOA proceedings were confirmed by the Dutch courts.

Since the first large Dutch scheme was a non-public WHOA proceeding, the name of the debtor is not publicly available. Nevertheless, it is commonly known in the restructuring market that the debtor group was operating a chain of fitness centres. The Dutch scheme was used to implement a financial restructuring involving a direct lender providing a senior term loan and a bank providing a super senior revolving credit facility. The second large Dutch scheme was the largest public WHOA proceeding so far and related to the restructuring of ADO Den Haag, a Dutch football (soccer) club that has played in the Dutch premier division for a number of seasons. The restructuring commenced due to the shareholder not providing capital to the club, resulting in a distressed M&A transaction where a new investor stepped in and acquired the club.

In both of these WHOA proceedings, several judgments were rendered by the Dutch courts, and important features of the Dutch scheme have been tested, reason enough for another update on the Dutch scheme which will be valuable to companies, lenders, and other creditors.

Fitness Centre Chain – Leveraged finance restructuring

The appointment of a restructuring expert

The WHOA provides for the appointment of a restructuring expert either at the request of the debtor or its creditors, shareholders or employee representative bodies. This Dutch scheme was initially commenced by the debtor, but subsequently, one of the creditors requested the appointment of a restructuring expert, which was supported by the majority of creditors. Even though one of the creditors strongly objected, the court decided to appoint the restructuring expert and ordered that his fees would be for the account of the creditors.

The creditors under the restructuring plan

When designing a restructuring plan using the Dutch scheme, the restructuring expert may choose to address the plan only to certain classes of creditors and/or shareholders and leave other classes of creditors out (and thus their position or claims unaltered). In the fitness centre chain restructuring, the restructuring expert included only three classes of creditors in the restructuring plan: (i) one super senior RCF lender with a claim of EUR 15 million (the **RCF Lender**); (ii) one senior Term Loan B lender with a claim of EUR 110 million (the **TLB Lender**); and (iii) the Dutch Tax Authorities. Trade creditors (and other creditors) were not included in the plan.

1 For the purpose of the WHOA, a debtor is an SME if (in short): (i) it runs an enterprise of less than 250 employees; and (ii) it generates a revenue of no more than EUR 50 million, or it has a total asset value of no more than EUR 43 million.

The content of the restructuring plan

Under the restructuring plan, the Dutch Tax Authorities were asked to agree to a repayment scheme, the shareholder was requested to make available additional liquidity of EUR 4 million, and amendments to the finance documents were proposed, e.g. rolling up of interest (PIK-interest), a covenant holiday and new financial covenants for the period thereafter. The proposed restructuring plan did not include a debt-reduction.

Interim decisions

The WHOA proceeding was quite litigious. During the process of preparing the plan, the restructuring expert asked the court twice for interim relief on questions that were important in the context of the restructuring plan. The Dutch scheme legislation provides an opportunity for the restructuring expert (or the debtor itself if no restructuring expert is appointed; but not for the creditors or shareholders) to request such interim relief.

The most interesting interim relief granted by the court in the context of this restructuring clarified the following matters under the Dutch scheme:

- A moratorium under the WHOA prevents the security agent from exercising the voting rights attached to the pledged shares, even if these have already been validly transferred to the security agent following an event of default and a notice to that effect;
- A ruling under the WHOA that certain creditors (or shareholders) may be put into a class and with the amount of their claim set only for voting purposes (i.e. the amount the creditor is entitled to vote on the plan) and not a ruling on the validity or amount of such claim for any other context;
- The parties involved in a WHOA proceeding are held to act reasonably and take into account the justified interests of the other parties involved, and if their behaviour constitutes abuse of law, this may have consequences for the exercise of their voting rights. (In this restructuring, that meant that the TLB Lender could not exercise the voting rights for debt it had purchased from the RCF Lender);
- The Dutch scheme legislation provides for a procedure to amend or terminate onerous contracts, but the amendment of financial covenants, maturity dates or other terms of the finance documents are a restructuring of creditors' rights and not a change of the contract and, hence, the procedure for amendment and termination of onerous contracts does not apply to such a restructuring of finance documents;
- After a fierce valuation fight relating to both the liquidation value as well as the reorganisation value, the court decided to establish the values as were presented by the financial advisers retained by the restructuring expert; and
- The Dutch scheme legislation provides for the exculpation or exclusion of liability of the restructuring expert only for damages resulting from efforts to compose a plan, and further exclusions of liability of the restructuring expert under the restructuring plan are, in principle, not permitted.

Voting and (the objection to) confirmation

The Dutch Tax Authorities voted in favour of the plan because the proposal was in line with the relevant internal guidelines of the Dutch Tax Authorities on accepting proposals in restructurings. The TLB Lender voted against the restructuring plan. The RCF Lender abstained from voting, given that it had sold and transferred its position to the TLB Lender in accordance with the provisions of the intercreditor agreement.

The restructuring expert submitted the restructuring plan to the court for confirmation requesting a cross-class cram down, given that the Dutch Tax Authorities voted in favour of the plan. The TLB Lender objected to confirmation arguing (among other things) that neither the 'best-interest-of-creditors test' nor the 'absolute priority rule' were satisfied.

The TLB Lender argued that it would be worse off under the plan than it would be in the event of liquidation of the debtor resulting in a violation of the 'best-interest-of-creditors test.' The TLB Lender supported its arguments with a fierce valuation fight. The court ruled, however, that the claim of the TLB Lender would remain partially unpaid in the event of liquidation based on the liquidation value, while the TLB Lender would receive full payment of its claim under the Dutch scheme. On this basis, the court ruled that the 'best-interest-of-creditors test' was satisfied.

Further, the TLB Lender argued that the ´absolute priority rule´ was violated by the plan. The court, however, ruled that all creditors involved in the Dutch scheme were receiving full compensation. Therefore, the 'absolute priority rule' was not breached even though the shareholder retained its interest.

Given that none of the grounds for refusal applied, the court confirmed the restructuring plan. As such, the TLB Lender and the RCF Lender were crammed down.

Key takeaways

Even in complex and litigious WHOA proceeding, the Dutch scheme can be a flexible, swift and well-designed restructuring tool. The judgments in this WHOA proceeding again underpin that preparation is key to a successful restructuring. In addition, requesting interim relief on issues that are unclear during the preparation of the restructuring plan, but which are crucial in order for the restructuring to succeed, appear to significantly contribute to the process. This right to seek interim relief regarding plan issues, which provides legal certainty throughout the process for all stakeholders, is one of the strengths of the Dutch scheme.

ADO Den Haag restructuring

The opening of the WHOA proceeding

ADO Den Haag had been experiencing financial challenges for several years, including a liquidity shortage. In response, the shareholder provided a liquidity guarantee, but then failed to pay under the guarantee (even after a court order obtained by the club). Consequently, ADO Den Haag filed a start declaration which marked the commencement of a public WHOA proceeding on 3 May 2021.

The court rendered various judgments in the WHOA proceeding which contain interesting elements worth elaboration.

Moratorium and protection against fraudulent conveyance

ADO Den Haag requested that the court: (i) declare a four-month moratorium; (ii) appoint a restructuring expert; and (iii) approve the transfer of one of the players to another soccer club. This approval was requested to eliminate the risk of claw-back on the basis of fraudulent conveyance in a subsequent bankruptcy (i.e. if the restructuring failed).

By judgment of May 25, 2021, the court:

- declared a moratorium up to and including 1 August 2021 (short of the debtor's request for a four month moratorium);
- granted the request to appoint a restructuring expert; and
- denied authorization for the player transfer.

Most interestingly, the court denied authorization to transfer of the player on the basis that it could not establish whether the proposed consideration for the transfer was at a fair market value and therefore would not be detrimental to creditors. Further, the court held that it was insufficiently explained whether the proposed transfer was necessary to finance the business of the debtor pending the preparation of the restructuring plan. However, the denial did not prevent ADO Den Haag from completing the transfer; it only deprived the transaction from claw back protection.

Extension of moratorium and authorization for bridge facility

During the proceeding, the restructuring expert requested an extension of the moratorium and approval of a secured loan from the municipality of The Hague.

On these matters, the court decided as follows:

- it extended the moratorium to 1 November 2021 on the basis that good progress was made in preparing the restructuring plan and that, according to the liquidity forecast, ADO Den Haag was able to meet its payment obligations through that date; and
- it denied authorization to enter into a secured loan with The Hague.

The court denied the club's request to enter into the secured loan with The Hague for various reasons. First, the court held that the parties were in an insufficiently advanced stage of negotiations as a result of which it was insufficiently clear when and under what circumstances the loan agreement would be concluded. Second, according to the liquidity forecast, ADO Den Haag did not require the full funding sought under the bridge facility. Third, the court ruled that according to ADO Den Haag's own statements in the draft loan agreement, approval of the facility was premature as it would only be necessary as of November 2021 and only if funding arrangements could not be agreed with an investor. Accordingly, the court held that the loan agreement was not shown to be necessary for ADO Den Haag to finance its business pending the preparation of a plan. The court, however, indicated that if in due time it were to become clear that the financing was indeed necessary after 1 November 2021 and that the statutory requirements were met, the club could re-submit a request to the court for authorization to enter into the loan with the municipality.

The restructuring plan

The restructuring expert proposed a restructuring plan in which the creditors and shareholders were divided into five separate classes: (i) class A consisted of the Dutch Tax Authorities as a preferential creditor; (ii) class B consisted of unsecured creditors; (iii) class C consisted of an intercompany creditor; (iv) class D consisted of a shareholder in its capacity as subordinated creditor; and (v) class E consisted of the shareholders as equity holders.

Under the plan, classes A and B would receive partial payment of their claim, classes C and D would be required to write-off their claims, and the shares held by the shareholders in class E would be revoked while a new investor would receive 100% of the newly issued shares as consideration for a capital contribution. Hence, the restructuring plan was used to implement a distressed M&A transaction.

On 1 December 2021, the restructuring expert submitted the draft restructuring plan to the various classes of creditors. None of the creditors or shareholders in these classes raised any objections to the draft plan.

Voting and confirmation hearing

The final plan was then submitted to the creditors and shareholders for a vote. Classes A, B, C and E voted in favour of the plan, class D abstained from voting.

Based on the outcome of the voting, the restructuring expert then submitted the plan to the court for confirmation. However, two parties came forward and raised objections to the confirmation. These parties were United Vansen International Sports Co. Ltd (**UVS**) (the sole creditor in class D and one of the shareholders in class E) and a creditor of UVS, which had levied a pre-judgment attachment on the UVS's shares in ADO Den Haag.

In respect of the latter, the court decided that, since the objecting entity was not a creditor of ADO Den Haag, it had no standing in the WHOA proceeding. The party argued that as an attachor in respect of the shares, it should be considered akin to a depository receipt holder (which may be given certain voting rights by the restructuring expert or debtor). The court, however, applied the statutory language strictly and rejected this argument.

In respect of UVS, the court ruled that UVS did not timely invoke any of the grounds for refusal of confirmation of the proposed restructuring plan, as (a) it did not timely raise objections when the draft restructuring plan was originally submitted on 1 December 2021 and (b) UVS did not vote against the plan, having abstained from voting. As a result, the court rejected UVS's objection to confirmation.

Key takeaways

There are two main key takeaways from the ADO Den Haag restructuring.

First, creditors or shareholders that wish to prevent a restructuring plan from being confirmed must make their objections known to the restructuring expert (or debtor) as soon as possible. Taking a passive role in the negotiations, reviewing drafts of the plan and abstaining from voting will cause the court to dismiss objections made by the relevant creditors or shareholders at a later stage. This is a special feature in the Dutch scheme legislation whereby creditors and shareholders have an obligation to make their objections known as soon as possible, failing which they lose their right to object to confirmation of the restructuring plan.

Second, the court in this WHOA proceeding strictly applied the legislation around granting authorization for transactions in order to eliminate the claw-back risks on the basis of fraudulent conveyance. The restructuring expert (or debtor) should duly prepare the transaction documents with agreed form documents being available, explain in what manner the transaction serves to finance the business of the debtor pending the preparation of the plan and explain why the transaction is immediately necessary. Making sure that the above issues are addressed may raise the chances of success in seeking such authorization.

Conclusion

Although the Dutch scheme initially was used mainly by SME debtors, it has now been successfully used in large restructurings as well. The published case law relating to the two largest restructurings under the Dutch scheme provide helpful lessons learned and guidance for potential debtors, investors and creditors. The Dutch scheme has proven to work very well in large restructurings, and its many features contributed to getting these two restructurings over the line. The key takeaways are (i) preparation by the debtor or restructuring expert is critical and (ii) on the other side, creditors or shareholders must be engaged and proactive to avoid losing the opportunity to oppose to the confirmation of a plan.

The WHOA proceeding relating to the fitness centre chain was conducted before the Amsterdam district court, and the WHOA proceeding relating to ADO Den Haag was conducted before The Hague district court. Although these are separate courts, it is expected that the other district courts of the Netherlands will apply the legislation in the same manner, given that the judiciary has assembled an expert pool of WHOA judges who work closely together across the various district courts.

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Harte Gold: Reverse Vesting Orders in Canadian restructurings to be used for necessity and not mere convenience

Evan Cobb

In prior issues of the *International Restructuring Newswire*, we reported on the prevalence of acquisitions in insolvency proceedings structured through Reverse Vesting Orders during 2020 and 2021. To recap, a Reverse Vesting Order allows for the transfer of liabilities and unwanted assets out of a target debtor company, rather than transferring the purchased assets out of the target debtor company, into a newly formed acquirer entity. The end result of a Reverse Vesting Order is to expunge the existing corporate structure of anything a purchaser does not want to acquire and see the debtor company successfully emerge from its restructuring process under the control of the acquirer and cleansed of those unwanted liabilities and assets.

The structure combines the benefits of a traditional restructuring plan of arrangement by keeping the existing debtor's corporate entity intact post-acquisition and also the benefits of the speed, efficiency and absence of a creditor vote that would be available in a traditional asset sale transaction.

Courts accepted that Reverse Vesting Orders could be used to implement acquisitions for a number of reasons:

- These transactions furthered the remedial objectives of Canadian restructuring statutes, being the timely, efficient and impartial resolution of the debtor's insolvency, value maximization, fair and equitable treatment of claims, the public interest and avoiding the social and economic losses resulting from the liquidation of an insolvent company.
- The debtor companies pursuing these transactions were proceeding in good faith and with due diligence.
- No other viable options were available that would suggest another alternative path.

Many of the considerations mentioned by the courts approving these transactions mirrored the considerations applicable to traditional sale or restructuring plan transactions. If the court's considerations were substantively the same for all such structures, one reasonably began to wonder whether the Reverse Vesting Order (which is not expressly provided for in Canada's restructuring statutes) would usurp the positions of the asset sale and restructuring plan transaction structures (which are expressly provided for in those restructuring statutes) as the tool chosen for all complex, distressed acquisitions in Canada.

If the Reverse Vesting Order structure entirely overtook other potential transaction structures in Canadian insolvencies, this would have significant implications. In particular, a debtor company would be able to pursue desirable transactions without creditor votes in all cases, and the protections that large creditors may otherwise believe they have available to veto a restructuring plan through a negative vote would become illusory for practical purposes.

The Ontario Court has recently sought to establish some limits on the use of the Reverse Vesting Order in the restructuring of *Harte Gold Corp.*, clarifying that it is not the ideal tool for all situations.

Harte Gold Corp.

Harte Gold Corp. was a public company with shares listed on the Toronto Stock Exchange and the Frankfurt Stock Exchange. It operated a gold mine in Ontario, Canada. The mine was producing and Harte Gold Corp. had over 200 employees on payroll. The company had 12 material permits and licenses they were required to have to maintain its mining operations and 24 work permits and licenses for exploration work, along with a variety of other licenses, mineral tenures and mineral claims.

Harte Gold Corp. was insolvent in late 2021 and commenced insolvency proceedings in Canada for the purpose of implementing a value maximizing acquisition transaction. The complexity, cost and potential risk and delay in the transfer of the above licenses, mineral tenures and mineral claims was a key consideration.

In these circumstances, preserving the assets within the existing corporate entity and avoiding the attempted transfer of permits, licenses and other items to a new corporate entity was desirable. Therefore, when pursuing a restructuring transaction, the Reverse Vesting Order was an attractive option to keep the existing corporate structure and desirable assets intact for the purchaser.

Following a marketing process, Harte Gold Corp. presented a transaction to the court for approval, which was described as follows:

In broad brush terms, the Silver Lake/833 purchase is structured as a Reverse Vesting Order. The transaction will involve:

- the cancellation of all Harte Gold shares and the issue of new shares to the purchaser;
- payment by the purchaser of all secured debt;
- payment by the purchaser of virtually all pre-filing trade amounts (estimated at CAD$7.5 million but with a CAD$10 million cap) and post-filing trade amounts;
- certain excluded contracts and liabilities being assigned to newly formed companies which will, ultimately, be put into bankruptcy. The excluded contracts and liabilities include a number of agreements involving ongoing or future services in respect of which there is little if any money currently owed. They also include a number of contracts with Appian entities and Orion, both of which support approval of the transaction. The employment contracts of four terminated executives will, however, be excluded liabilities, which will nullify the value of any termination claims. Notably, excluded liabilities does not include regulatory or environmental liabilities to any government authority;
- retaining on the payroll all but four employees (the four members of the executive team whose employment contracts will be terminated); and
- releases, including of Harte Gold and its directors and officers, the Monitor and its legal counsel and Silver Lake and its directors and officers.

The court had no difficulty quickly concluding that it had the power to grant a Reverse Vesting Order. However, the question of when that power should be exercised required further consideration. The court explained:

A. Canada's restructuring statutes do not deal specifically with the use or application of a Reverse Vesting Order structure.

B. The judicial authorities approving this approach, while there are now quite a few, do not generally provide much guidance on the positive and negative implications of this restructuring technique or what to look out for.

C. It would be wrong to regard employment of the Reverse Vesting Order structure in an insolvency situation as the "norm" or something that is routine or ordinary course.

D. The Reverse Vesting Order should continue to be regarded as an unusual or extraordinary measure, not as an approach appropriate in any case merely because it may be more convenient or beneficial for the purchaser.

E. Approval of the use of a Reverse Vesting Order structure should, therefore, involve close scrutiny.

The court proposed a non-exhaustive series of questions that should be considered in connection with approval of a Reverse Vesting Order transaction:

A. Why is the Reverse Vesting Order necessary in this case?

B. Does the Reverse Vesting Order structure produce an economic result at least as favourable as any other viable alternative?

C. Is any stakeholder worse off under the Reverse Vesting Order structure than they would have been under any other viable alternative? and

D. Does the consideration being paid for the debtor's business reflect the importance and value of the licences and permits (or other intangible assets) being preserved under the Reverse Vesting Order structure?

The court granted the Reverse Vesting Order in the *Harte Gold* case based upon the above considerations.

Implications of Harte Gold Decision

While this is only one decision in one jurisdiction, out of a collection of many decisions from many jurisdictions on the Reverse Vesting Order in Canada, the *Harte Gold* decision highlighted an issue that many practitioners were considering.

As a practical matter it is not yet clear that the new enumerated considerations applicable to Reverse Vesting Orders will limit the availability of the structure generally.

Considerations (B) and (D) above would appear to mirror similar considerations in any restructuring transaction, regardless of legal structure. A court would consider whether a transaction, under any legal structure, produces

an economic result at least as favourable as other options and would also consider whether the consideration being paid reflects the importance and value of the assets being transferred.

We find considerations (A) and (C) to be unique aspects of the analysis focused on the question of why a Reverse Vesting Order, instead of an asset sale or a restructuring plan, is *necessary*, and whether any stakeholder is prejudiced by the selected structure.

From the limited guidance available at this stage, it appears that 'necessity' is a flexible concept and does not mean that there is absolutely no other possible avenue to implement the transaction. Rather, the available analysis suggests that necessity, in this context, is aimed at determining if the Reverse Vesting Order is reasonably required because of the impracticality of other options. Examples of necessity included that an alternative asset sale structure would require a longer process with uncertain results to transfer permits, contracts and licenses, which the purchaser or other parties (e.g. shareholders or lenders) would reasonably not fund. It will be interesting to see how strictly courts follow this 'necessity' requirement in the future.

Whether any stakeholder is worse off through the Reverse Vesting Order structure than they would have been under any other viable alternative is an interesting consideration. Importantly, any relevant alternative must be *viable*. For example, it should not be sufficient for an objecting creditor to argue they are worse off because the Reverse Vesting Order structure eliminates their right to vote on a hypothetical restructuring plan in a case where no such restructuring plan would ever reasonably be put forward. Rather, the question for the objecting creditor is whether another alternative method of achieving the transaction outcome is practically achievable, does not require the Reverse Vesting Order and would leave the creditor in a better position. In many ways, this consideration overlaps with the consideration of (A) above.

It remains to be seen how *Harte Gold* will be interpreted and applied in practice. However, in principle, it begins to position the Reverse Vesting Order again as the exception to the traditional asset sale and restructuring plan options in Canadian proceedings, rather than the new standard approach for distressed acquisitions in Canada.

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Additional help for companies in crisis: Italian government amends and extends COVID19 relief

Tiziana Del Prete, Giuseppe Pastore

The Italian government continues to extend measures to provide businesses with relief and support to address the economic impact of COVID-19 in order to avoid compelled liquidations that would harm companies and their stakeholders in the current environment.

The government recently approved an amendment to Legislative Decree No. 228 of December 30, 2021 (known as the ***Milleproroghe* Decree**), converted into Law No. 15 of February 25, 2022, which is aimed at extending and expanding relief to Italian companies in crisis.

Specifically, the amendment extended certain provisions enacted during the COVID-19 pandemic that relaxed and waived certain Debt to Equity Ratio Rules for Italian companies.

Background

There are various rules and remedies under Italian law that apply to companies that suffer losses affecting the "integrity of the corporate capital of the company", depending on the severity of the losses.

For example, the normal and applicable relevant debt-to-equity ratio rules (**Debt to Equity Ratio Rules**) are as follows:

- The Italian Civil Code (article 2446, paragraphs 2 and 3, and article 2482-bis, paragraphs 4, 5 and 6) provides that:
  - If, as a result of the losses, the corporate capital decreases by more than one third, but is still not less than the minimum legal requirement, then the directors of the company (and, in the event of their inaction, the board of statutory auditors of the company), must promptly call a shareholders' meeting to pass appropriate resolutions and measures.
  - Moreover, if, by the end of the next financial year, the corporate capital decrease has not been improved such that it is less than one third, then, at the ordinary shareholders' meeting to approve the financial statements for that subsequent year, a resolution must be made to reduce the corporate capital in proportion to the losses ascertained.
  - In the event that this is not accomplished at the ordinary shareholders meeting, it is the duty of the directors and auditors of the company to obtain a court order to reduce the corporate capital in proportion to the losses indicated in the company's financial statements.
- The Italian Civil Code (article 2447 and article 2482-ter) provides that:
  - If, as a result of the losses, the corporate capital decreases by more than one third, and also results in the corporate capital falling under the minimum legal requirement, then the directors of the company must promptly call a shareholders' meeting to resolve the reduction of the corporate capital and simultaneously either (i) increase the corporate capital to an amount not less than the minimum required by law or (ii) change the legal form of the company.
- Finally, the Italian Civil Code (article 2484, paragraph 1, no. 4) and article 2545-duodecies) sets out the circumstances that give rise to an obligation to liquidate a company because of a reduction or loss of corporate capital.

The 2020 Liquidity Decree

On April 8, 2020, in response to the business crisis created by the COVID-19 pandemic, the Italian government passed the Liquidity Decree (Law Decree no. 23 of April 8, 2020, *Decreto Liquidità*). The Liquidity Decree temporarily suspended the Debt to Equity Ratio Rules for all joint stock companies, regardless of whether the company was subject to a bankruptcy or insolvency proceeding.

This important legislative intervention was designed to address two problems that would arise from the application of the Debt to Equity Ratio Rules. First, the Liquidity Decree served to prevent the compelled liquidation of companies that were in situations of capital deficit due to extraordinary and unforeseeable losses suffered, at least in part, due to

the COVID-19 pandemic. Second, it helped shield company directors from exposure to claims for damage caused to the company, the shareholders, the company's creditors and/or third parties, as a result of continuing the operation of the business in the face of causes for the liquidation of the company under the Debt to Equity Ratio Rules.

The wording in the Liquidity Decree, however, was unclear and raised numerous interpretative questions regarding which losses creating the capital deficit were to be considered subject to the relaxation of the Debt to Equity Ratio Rules.

In that regard, article 6 provides for the suspension of the application of the Debt-to-Equity Ratio Rules, starting from the date of the entry into force of the Liquidity Decree (i.e., April 9, 2020) through December 31, 2020, for the situations (*fattispecie*) that occurred during the financial year ending on December 31, 2020. Questions were raised as to whether the suspension provided by the Liquidity Decree could cover those situations where the losses may have accrued before April 9, 2020, but were not recognized until after such date, or whether only losses that accrued between April 9 and December 31, 2020, could be considered. The prevailing interpretation was that losses accrued prior to the April 9, 2020 date could also be considered.

Budget Law 2021 provides additional runway to remedy the losses

Budget Law 2021 (article 1, paragraph 266, of Law no. 178 of December 30, 2020) further extended the timeline to recoup the capital loss for several years.

— In the situations referred to in articles 2446 and 2482-bis of the Italian Civil Code, the deadline by which the losses must have been reduced to less than one third of the corporate capital has been extended to the 2025 financial year;

— In the situations referred to in articles 2447 or 2482-ter of the Italian Civil Code, the shareholders' meeting may resolve to postpone the decisions to reduce the corporate capital (and simultaneously increase the same) until the relevant shareholders' meeting for the 2025 financial year;

— Until the date of the shareholders' meetings for the 2025 financial year, the rules regarding the obligatory liquidation of the company due to a reduction or loss of corporate capital, as set out in articles 2484 and 2545-duodecies of the Italian Civil Code, do not apply.

Moreover, Budget Law 2021 specified that "*losses emerging in the financial year in progress as of December 31, 2020*" should refer to all losses in the 2020 financial statements (including also those losses accrued in previous financial years, provided that they are recognized during the 2020 financial year). Therefore, the losses that are subject to the suspension may be: (i) losses in the 2020 financial year, (ii) losses deriving from financial years prior to 2020 and carried forward, as well as (iii) certain losses accrued after December 31, 2020, provided that they emerge during the months preceding the approval of the financial statements for the year ending December 31, 2020.

In addition, a specific correlation between the COVID-19 pandemic and the generation of losses is not required. Apparently, the Italian government intended to take into consideration overall market difficulties, even those unrelated to the COVID-19 pandemic.

Finally, it is important to note that while the Liquidity Decree provides important relief, it does not suspend certain relevant legal obligations. In particular: (i) the directors still must promptly identify the losses and call a shareholders' meeting without delay; (ii) the directors still must present to the shareholders' meeting the report on the company's financial situation; and (iii) for the purposes of applying the favorable regulations provided in the Budget Law 2021, the notes to the financial statements must contain a specific indication of the origin of the losses incurred.

Further relief in 2022

Most experts believed that that Italian government would take a break from further relief heading into 2022. Surprisingly, however, Budget Law 2022 introduces a new, special extension of the terms regarding the coverage of losses of joint-stock companies.

In particular, the government provided that, the Debt-to-Equity Ratio Rules and the requirement to liquidate companies due to reduction or loss of corporate capital pursuant to articles 2484, paragraph 1, number 4) and 2545-duodecies do not apply to joint stock companies in relation to losses accrued in the financial year ending as of December 31, 2021.

These 2021 losses must be recovered in the 2026 financial statements (again providing an approximate five year remedy period).

It should be noted that while the 2020 losses must be recovered with 2025 financial statements (and therefore by the spring of 2026), the 2021 losses shall be reduced to less than one third of the capital with approval of the 2026 financial statements, and therefore in the spring of 2027.

Conclusions

As demonstrated by its actions, the Italian government remains in favor of continuing to support companies in crisis by suspending the legal obligations established by Italian law that follow the well-known (and sometimes harsh) principle of "recapitalize or liquidate".

Moreover, the new rules demonstrate that the Italian government is prepared to give companies in crisis the time necessary to effectively carry out a reorganization/recapitalization plan to successfully overcome a temporary state of crisis brought on, at least in part, by the COVID-19 pandemic. In fact, five years is about the same time horizon that generally is envisaged in the context of corporate reorganization plans or, in any case, by composition plans, debt restructuring agreements and certified plans.

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Public examination powers by private parties significantly increased by High Court of Australia

Jeffery Black, Nick White and Nathan Giacci

The High Court of Australia's recent decision in Arrium has significantly expanded the purposes for which a Court may summon an officer of a corporation for examination by private parties about the corporation's examinable affairs. In particular, the decision is a big win for shareholders seeking to bring class actions, or otherwise bring claims against the officers of distressed and insolvent corporations, who can use this power to obtain information and documentation that will enable them to assess the prospects and potential recoveries such a claim may bring. It is foreseeable that the decision will result in an increase in public examinations being used as a tool by private parties – shareholders and creditors – seeking to initiate litigation relating to claims against the directors of companies in liquidation and/or other forms of insolvency proceedings.

Overview

In Australia, section 596A of the *Corporations Act 2001* (Cth) (the **Act**) empowers "eligible applicants" to apply to the court for orders to examine a person about a corporation's affairs. The power is mandatory. If an application identifies a person falling within the classes of person specified in s 596A (for example, an officer of the company in the two years before external administration) the court must issue an examination summons. Those who were conferred the ability to use these "extraordinary" powers were historically limited, to reflect the encroachment on the common privileges of an individual summoned.

The recent decision of the High Court of Australia in *Walton v ACN 004 410 833 Limited (formerly Arrium Limited) (In Liquidation)* [2022] HCA 3 has significantly expanded the purposes for which an eligible applicant may summon a person for examination.

The majority of the High Court (in a 3:2 decision) decided that in light of the changes made to the Act, the purposes for which the power can be used, are much broader than the earlier examination provisions, and specifically enabling the "extraordinary" power to be used for shareholders (and other individuals who may have suffered loss) to undertake examinations for the purpose of undertaking private litigation against former officers of the corporation. In doing so, there is no requirement that the examination relate to the external administration or be to the benefit of the company or the company's creditors.

Consequently, the decision represents an important win for promoters of shareholder class actions and creates the potential for increased litigation connected with corporate liquidations generally.

Examination powers

Pursuant to section 596A of the Act, it is mandatory for the court to make an order for the summons of a person for examination about a corporation's examinable affairs if:

- an "eligible applicant" applies for the summons; and
- the Court is satisfied that the person being summoned was an officer or provisional liquidator of the company within, in the case of restructuring, two years from the day on which the restructuring of the company began.

The section is typically used by insolvency practitioners to obtain information from the former officers of the company either to investigate potential misconduct by a company's directors and officers, or in order to commence appropriate proceedings for the benefit of the company, its creditors and shareholders (for example, to challenge antecedent transactions).

However, the scope of section 596A is broader than the typical use, and can also be used by the Australian corporate regulator, the Australian Securities and Investment Commission (**ASIC**), or other third parties who obtain authorisation from ASIC (such as the appellants in the Arrium case).

Eligible applicant

The Act defines "eligible applicant" as: (i) ASIC; (ii) a liquidator or provisional liquidator of the corporation; (iii) an administrator of the corporation or of a deed of company arrangement executed by the corporation; (iv) a restructuring practitioner for the corporation; or (v) a person authorised in writing by ASIC.

There is no limitation on who may be authorised by ASIC under (v), but the High Court acknowledges that ASIC would exercise discretion as to whom it would authorise in the public interest, and that it would be unlikely to do so to support an illegitimate, vexatious or oppressive examination being undertaken.

Examinable affairs

The term "examinable affairs" is a very broad concept, and refers to a number of matters, including:

- the promotion, formation, management, membership, control, business, trading, transactions and dealings of the company;
- in cases where the company is a trustee, matters concerned with the ascertainment of the identity, rights and entitlements of beneficiaries;
- the internal management of the company;
- any act or thing done in the administration, restructuring or winding up of the company;
- matters concerned with the ascertainment of the persons who are or have been financially interested in the success or failure of the company; and
- matters relating to or arising out of an audit.

Historical position

The examination powers under the Act are significant and result in the denial of significant individual privileges (for example, the privilege in relation to self-incrimination is not available as a basis to refuse to answer questions in the examination). As a result, examination powers are considered "extraordinary" powers, and which the Courts have typically found to be limited in scope.

The purpose and existence of section 596A reflects an overarching public policy to facilitate the administration of a struggling company, recoup debts for creditors, and hold directors and officers who are responsible for misconduct or other breaches of statutory duty to account. The historical limit in scope and application of the examination powers reflects a hesitancy of courts to permit private parties to use such "extraordinary" examination powers in a parochial manner to benefit themselves in litigation. This limit reflects the public policy balance between a party's interests and the public interest in the proper administration of companies and is reflected in the decisions of the Court of Appeal and in the dissenting judgement in the High Court.

Despite the general inability of individual parties to make an application for the use of examination powers, creditors and contributories have been acknowledged as eligible applicants, when authorised by ASIC, and when good reason for making an application for examination powers by those individual creditors can be demonstrated. For example, if the use of examination powers can be shown to accrue a benefit to a company's creditors or contributories generally, this has historically been sufficient for examination powers to be conferred.

Background to the proceedings

The appellants were former shareholders of Arrium, a publicly listed Australian mining company that produced steel and iron ore. Arrium announced a capital raising exercise in 2014 which raised AU$754 million. In 2015, Arrium announced that its mining operations were to be suspended, and subsequently acknowledged that a significant reduction in the value of its operations would follow. In 2016, Arrium (and other companies within its group) entered administration.

In 2018, the former shareholders were granted status as "eligible applicants" by ASIC and successfully applied for orders in accordance with section 596A to examine a former director of Arrium and to require the production of certain documents. Similar orders were also sought, and awarded, against the auditor and the bank who advised on the capital raise. The targets sought to have the orders set aside.

In the set aside application, it was undisputed that the former shareholders sought to examine the director about the examinable affairs of Arrium. It was also undisputed that their ultimate purpose was to investigate whether a potential class action, on behalf of a particular class of Arrium shareholders against the former officers and advisers of Arrium, could be pursued. The foreshadowed class action would seek the recovery of losses suffered by shareholders as a consequence of the capital raise in 2014.

The primary judge declined to set aside the orders, but the New South Wales Court of Appeal disagreed and reversed that decision. It found that the former shareholders' examination application was for the predominant purpose of pursuing a "private" benefit to be enjoyed by only a limited class of shareholders. The examination powers would not confer a generalized benefit on Arrium, its creditors or its contributories. Consequently, the Court of Appeal decided that the examination served a purpose foreign to section 596A and was therefore an abuse of process.

The former shareholders appealed to the High Court of Australia (being the highest appellate jurisdiction in Australia).

Decision of the High Court of Australia

The majority of the High Court (3:2) found that the Court of Appeal's narrow interpretation of the purposes for permitting a section 596A examination was a decision made in error. The majority found that although it would be an abuse of process if the appellants' purpose was foreign to the purpose of 596A, this was not the case in these circumstances.

In determining whether the application for an examination was an abuse of process, the majority of the Court said that:

- the test to be applied was "*whether the predominant means adopted and ends to be achieved by a litigant (in other words, the litigant's purpose) are consistent with the express or implied scope of the legal process*"; and
- when the alleged abuse of process relates to a statutory process, an abuse of process will only be found if the litigant's ultimate purpose would contradict the scope and purpose of that statute. The existence of an ulterior motive is irrelevant if that motive is not inconsistent with the scope and purpose of the legislation.

Here, the purpose of the former shareholders' application was not in dispute. It was accepted that the appellants sought an examination order to investigate potential claims against the former directors and auditors of Arrium. It was further accepted that the shareholders had no claim against Arrium itself, that no claims could be brought by Arrium or its creditors against the directors (who had benefited from the capital raise) and that the potential claims could only be brought by a specific sub-class of Arrium shareholders.

The question that the High Court had to determine was whether such a purpose fell outside of the scope of the statutory purpose of section 596A.

Purpose of s 596A

In considering the purpose of section 596A, the High Court reviewed the legislative history of examination powers (both with respect to the Act and its predecessors), and considered the evolution of the criteria for obtaining an examination. In doing so, the court observed that section 596A "broke away from the general model" by significantly broadening the "eligible applicants" who may apply for an examination summons, expanding the scope of what constitutes the "examinable affairs" of the company and removing the Court's discretion to grant the orders summoning a person for examination.

The majority of the court held that the statutory history, context and terms of section 596A demonstrated that a characterisation of the purpose of the section, at a higher level of generality than its terms, should not be curtailed by "*muffled echoes of old arguments*" concerning its predecessors. In particular, its purpose could not be confined by reference to the existence of a benefit to the company, its creditors or its contributories. The authorities concerning earlier provisions were therefore of limited assistance in interpreting section 596A. As the scope of application of section 596A expanded, so too did its underlying purpose and concern. Its purpose was therefore:

> "to address, by examinations of present or former corporate officers or provisional liquidators, the administration or enforcement of the law concerning the public dealings of the corporation in external administration and its officers."

In making its finding, the Court referred to the shareholders' submission that ASIC (or persons authorised by ASIC) were empowered by section 596A to apply for a summons in the furtherance of ASIC's statutory duties, which may ultimately confer no benefit on a company, its creditors or its contributories.

ASIC is Australia's integrated corporate, markets, financial services and consumer credit regulator, which is under a statutory duty to, amongst other things (a) maintain, facilitate and improve the performance of the financial system and the entities within the system (b) promote the confident and

informed participation of investors and consumers in the financial system and (c) enforce and give effect to relevant laws, including the Act. Consequently, it followed that the legitimate purposes of section 596A included:

- the enforcement of the Act;
- the promotion of compliance with the Act; and
- the protection of shareholders or creditors from corporate misconduct.

Accordingly, the existence of a private benefit does not exclude the potential for there to also be a legitimate purpose. A summons for examination will not be an abuse of process unless the predominant purpose of the examination would contradict the public interest in the external administration of a company:

> *An examination conducted for a purpose that included investigating the possible existence of misconduct on the part of a company's officers might be expected to serve the public interest in ways such as these. Hence**, regardless of whatever ultimate purpose a litigant might have**, a summons that is sought for a **substantial purpose** that*

> ***includes the public purpose of enforcement of the Corporations Act**, whether by ASIC or another eligible applicant, is **not a summons sought for a purpose foreign to s 596A in the sense that it is inconsistent with the purposes of s 596A**. And the purpose of enforcement of the Corporations Act includes examination for the purpose of determining whether relief might be obtained in respect of potential corporate misconduct.*

The "draconian" remedy of setting aside a summons for an improper purpose would usually be inappropriate where the threat of an abuse of process could appropriately be managed by the court through the making of appropriate directions and controlling what questions might be asked. The setting aside of the summons should be seen as a "last resort" and "reserved only for the most exceptional or extreme cases".

The High Court concluded that the shareholders' application to examine a former officer for the purpose of pursuing a claim against Arrium's officers or advisers was a purpose consistent with the enforcement of the law, and thus was a legitimate use of the power conferred by section 596A. It followed that it was not an abuse of process. Furthermore, the pursuit of a claim for the benefit of *some* shareholders can be just as legitimate as a claim made for *all* shareholders. In both cases, money recovered from corporate misadventures and the associated encouragement of compliance serves the public interest of enforcement of, and compliance with, the Act.

Implications of this decision

This decision significantly broadens the purposes for which an examination may legitimately be brought pursuant to section 596A of the Act. Importantly, it confers a significant power that may be used by individual parties – creditors and shareholders alike – who may have claims against insolvent companies or their directors to obtain information that would enable them to assess the prospects of, and likely recoveries from, those claims. This will enhance the potential for those parties to identify sufficient information to be able to bring claims, and obtain funding to do so.

The decision may therefore lead to an increase in applications to ASIC from parties seeking to use the examination power to gather information about possible individual claims. It may also result in a greater willingness from ASIC to authorise examinations consistent with the High Court decision.

However, the impact of the decision is not without limitations. The role of ASIC in authorising eligible applicants will not be exercised without a consideration of the basis upon which the examination is to be undertaken. The Court will also use its extensive case management powers to manage the examinations and ensure that the questions are restricted to the "examinable affairs" of the corporation.

However, at the very least, the decision will enhance the investigative powers available to shareholders and creditors in obtaining information that will enable them to assess potential claims (which at least for shareholders are likely to be brought as class actions).

The decision may also be of interest to shareholders and creditors in other jurisdictions. The examination power under section 596A is not limited to Australian companies, and accordingly, there may be the potential for examinations to be undertaken in connection with cross-border proceedings involving an Australian main or ancillary insolvency case.

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