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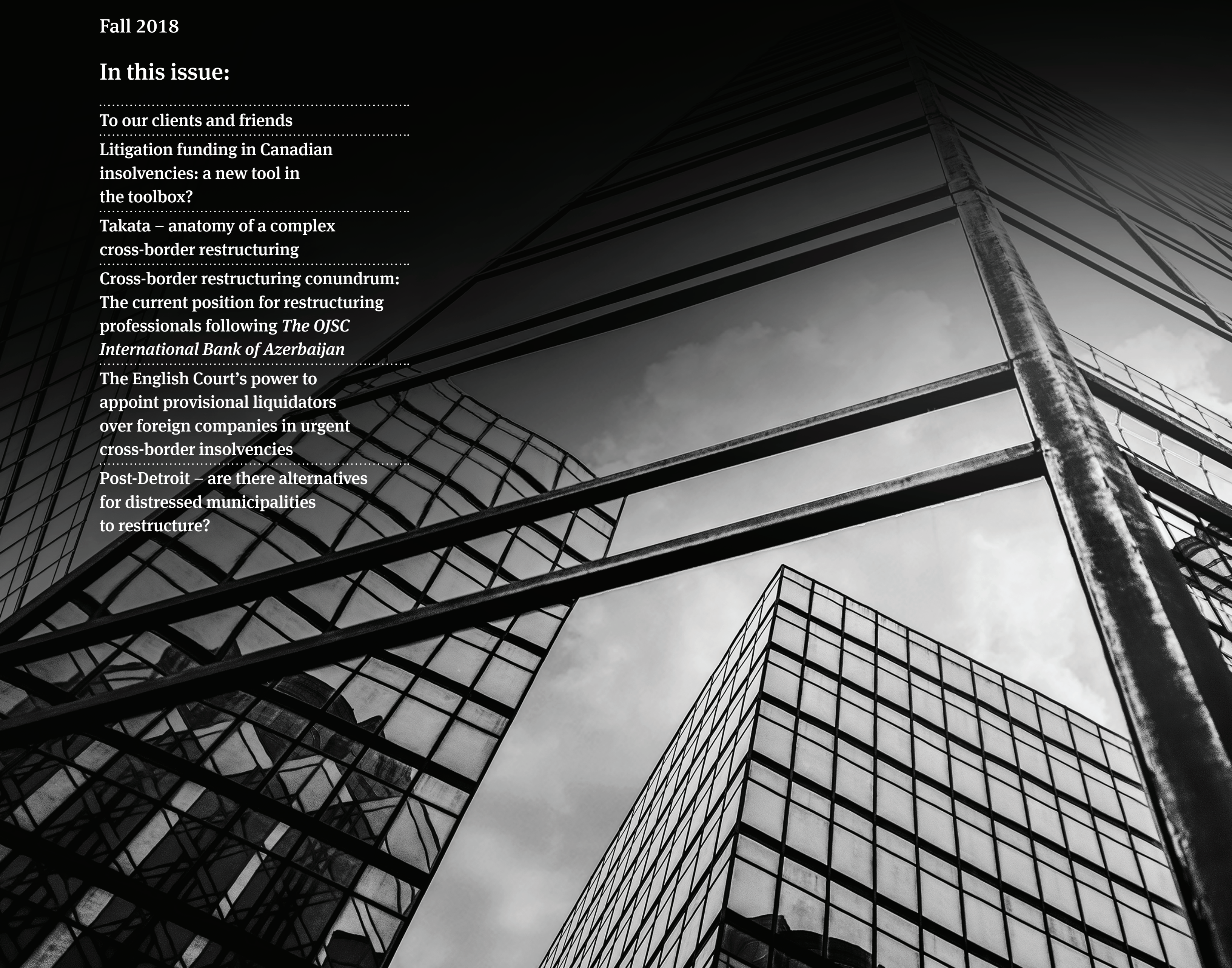
NORTON ROSE FULBRIGHT

International Restructuring Newswire

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

Fall 2018



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International Restructuring Newswire

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To our clients and friends:

Last month marked the ten-year anniversary of the collapse of Lehman Brothers. We hosted a conference in our London office to discuss how the financial landscape has changed and what lessons have been learned (or not).

I had the pleasure to speak at the event along with Sarah Coucher, a restructuring partner in our London office, and our special guest, former UK cabinet minister Ed Balls. Ed gave his insights on the financial crisis from a UK perspective.

The financial crisis and the resulting Great Recession took a tremendous toll on the US: trillions of dollars of wealth were destroyed and nine million jobs lost. I addressed what things look like in the US ten years on from the demise of Lehman. And the economy looks upbeat indeed. Last month marked the longest bull market on record, with the S&P 500 Index hitting an all-time high. It has been a remarkable run since the end of the financial crisis with record level corporate earnings. Inflation has been manageable; unemployment is down from a high of 10% to its current level of 3.7%. The housing market is back with home prices up. The US economy seems to be churning at nearly full strength.

Yet there are some worrying signs that the lessons learned from the financial crisis are being forgotten with our surging economy. Three things in the US to be concerned about:

- Relaxation of Regulatory Oversight: In the wake of the financial crisis, legislation was passed by Congress to more closely regulate financial institutions. In May of this year, Congress voted to roll back parts of that law (Dodd-Frank) to limit stricter federal oversight to only the ten largest banks. There is under discussion the further loosening of bank regulation by relaxing the Volker Rule and easing capital requirements for banks. While our large financial institutions will certainly welcome relief from what they view as overly restrictive regulation, others worry that the lessons from Lehman are being forgotten as governmental oversight is being cut back.

- Risky Lending: The amount of risky lending in the US has increased enormously with less regulation and transparency. While US banks are clearly stronger than before the financial crisis, the less-regulated “shadow” banking system has grown enormously. Leveraged lending has migrated to investment banks, private-equity and hedge funds. Banks are still making these higher-risk loans, but they quickly sell them off to investors, have them packaged as collateralized loan obligations (CLOs) or sold to ETFs and mutual funds. This leveraged

In the news

July

New York, NY
Howard Seife was featured in a recent “Currents” podcast speaking on what happens when a power purchaser files for bankruptcy, using the recent Chapter 11 filing by First Energy Solutions as a case study. As more power projects are financed based on projected cash flows from corporate PPAs, Mr. Seife discussed the credit risks IPPs may be presented with by a potential bankruptcy of their counterparty.

September

Munich, Germany: September 21, 2018
Howard Beltzer, David Rosenzweig and Christian Abel spoke at Norton Rose Fulbright’s Aviation Summit in Munich. The panel’s discussion topic was *“Airline Restructurings: A Transatlantic Perspective.”*

London, UK: September 27, 2018
Norton Rose Fulbright hosted a client event in London to mark the ten year anniversary of the collapse of Lehman Brothers. Howard Seife and Sarah Coucher spoke about the current state of the market, potential risks and actions being taken. The event included a discussion with Ed Balls, who served in the Labour Government as UK Minister for Financial Services, Chief Economic Advisor to the UK Treasury and Education Secretary.

New York, NY: September 27, 2018
David Rosenzweig hosted a meeting among members of the New York City Bar Committee on Bankruptcy and Corporate Reorganization and a delegation from Serbia regarding improving bankruptcy legislation and processes. The Serbian delegation included representatives from the Belgrade Commercial Appellate Court, the Serbian Ministry of Economy, the Serbian Bankruptcy Supervisory Agency and the Belgrade Mayor’s office.

December

Scottsdale, Arizona: December 7, 2018
Christy Rivera will participate on a panel at ABI’s 2018 Winter Leadership Conference. The panel will discuss safe-harbor issues after the *Lehman* bankruptcy.

In the news

Insolvency Institute of Canada

Virginie Gauthier (Toronto) and Luc Morin (Montreal) were recently invited to join the Insolvency Institute of Canada (IIC). Members of the IIC are drawn from the most senior and experienced professionals representing the insolvency community in Canada. They are lawyers, trustees, and restructuring specialists who are joined by representatives of regulatory and compensation bodies, major financial institutions, lenders, financial advisers, and prominent members of the academic community. Howard Gorman (Calgary), Tony Reyes (Toronto), Julie Himo (Montreal) and Sylvain Rigaud (Montreal) are also members of the IIC.

California Lawyers Association -- Insolvency Law Committee

Rebecca Winthrop was recently named Co-Chair of the Insolvency Law Committee of the California Lawyers Association (the former California State Bar Association).

loan market is estimated to be as large as $1 trillion. And US corporate credit quality has become increasingly "junky." As noted in a recent report from FTI Consulting, "US corporate credit metrics . . . are worse today than in mid-2007 when the previous credit cycle was peaking. Currently, 56% of all S&P rated US corporate issuers are speculative-grade compared to 49% in 2009." So far defaults have been low, but that could change quickly if the economy falters or if interest rates rise significantly.

- Growing Federal Deficit: It is predicted that new US tax cuts will reduce federal revenue by $1.5–$2 trillion over the next ten years. When you add increases in spending, the Office of Management & Budget projects the deficit for fiscal 2019 to be over $1 trillion, bringing total US government debt to over $24 trillion. Within a decade more than 13% of the US budget will go to pay interest–$900 billion annually (more than funding for defense). This puts us in unchartered territory: usually government borrowing drops during recoveries and expands during recessions. This risk was put succinctly by Pulitzer Prize columnist Thomas Friedman in *The New York Times* "increasing the deficit when your economy is growing nicely is really, really reckless – because you may need that money to stimulate your way out of the next recession."

So, as we discussed at our conference in London last month, are we shunning financial prudence in the US and ignoring relevant lessons from the financial shocks of 2008? Time will tell.

On that upbeat note, I hope you find our latest issue of the International Restructuring Newswire to be of interest.

Howard Seife
Global Head
Financial Restructuring and Insolvency

Litigation funding in Canadian insolvencies: a new tool in the toolbox?

Alex Schmitt

The high (and rising) cost of complex commercial litigation proceedings remains one of the defining features of litigation in Ontario, and across Canada more broadly. In deciding whether to litigate a claim, lawyers and their clients must assess not only a claim's substantive merits, but also whether it is economically viable to pursue. More and more, it is the economic cost of pursuing a claim—irrespective of its substantive merits—that increasingly dictates if and how that claim will be litigated. This has profound implications for the legal system: legal rights are illusory and no more than a source of frustration if they cannot be recognized and enforced.

Where the would-be claimant is an insolvent company, that concern is necessarily escalated and it often means that debtors and those appointed to administer their estates do not always maximize the value realizable from all potential claims. Although in-progress litigation and claims arising out of insolvency can represent an important source of funds for an insolvent estate, even for large estates there will often not be the funds or the confidence to proceed, particularly in the face of the potential for adverse costs awards.

One potential new tool to help with this situation is third-party litigation funding. Under these arrangements, a third party who is otherwise unrelated to the litigation agrees to fund all or part of the claimant's litigation costs, often also indemnifying them against any adverse costs awards, in return for a portion of that claimant's recoveries in damages or costs should the funded party succeed.

While the Canadian market for such arrangements outside the class actions context is still very much developing, elsewhere it has assumed a prominent role. Numerous funds have sprung up in the United States, United Kingdom and elsewhere to fund everything from consumer litigation, including personal injury and other tort claims, to complex commercial disputes, and litigation funding is estimated to represent a multi-billion industry globally. In Canada, most litigation and arbitration arrangements have historically been funded on an inbound basis from UK and US-based funders, but that may be changing. Australia-based specialist litigation funder Bentham IMF opened offices in Toronto in 2016, expanding to Montreal this past summer, and in their first year in operation received over 100 applications for funding.

Bluberi: Quebec Court approves litigation funding in insolvency proceedings

Indeed, one of their first funded cases resulted in one of the first ever approvals of a litigation funding agreement in Canada for an insolvent company operating under the protection of the *Companies' Creditors Arrangement Act*, Canada's primary large commercial restructuring statute. In *9354-9186 Quebec Inc. (Bluberi Gaming Technologies Inc.) v. Ernst & Young Inc.*, 2018 QCCS 1040, the insolvent debtor Bluberi's only remaining asset was a potential lawsuit worth as much as $200 million that it sought to assert against its former secured lender, alleging that it caused Bluberi's demise as part of an aggressive "loan to own" strategy. With only limited financial resources however, Bluberi could not afford to take on and pursue the claim on its own for the benefit of its creditors.

Bluberi and its counsel therefore entered into a litigation funding agreement with Bentham whereby it agreed, subject to court approval, to pay Bluberi's costs of the litigation in return for a portion of its proceeds, if successful, including a priority charge for such amounts for the first $20 million. If the litigation were unsuccessful, Bentham would lose its investment. As to Bluberi's counsel, it would receive a reduced hourly rate on monthly billings to be paid by Bentham, as well as a deferred payment and performance bonus that would both be contingent on a successful outcome.

The court-appointed monitor[1] in the case supported the agreement and Bluberi moved for its approval as well as a super-priority court-ordered charge to secure Bluberi's obligations thereunder. The lender for its part brought a cross-motion for approval to call and hold a meeting of creditors to approve its own plan of arrangement, through which the lender would be released from any liability to Bluberi.

In his decision, Justice Michaud of the Superior Court of Quebec approved Bluberi's funding arrangements, finding that in an insolvency context third party funding arrangements should generally be approved, subject to the following principles:

> (a) The third party funding agreement must be necessary to provide the plaintiff access to justice that would not otherwise be available to it;
>
> (b) The plaintiff's right to instruct counsel and control the litigation should not be diminished by the third party funding agreement;
>
> (c) The third party funding agreement must not compromise or impair the lawyer and client relationship or the lawyer's duties of confidentiality;
>
> (d) The compensation of the third party funder must be fair and reasonable; and
>
> (e) The third party funder must undertake to keep confidential any confidential or privileged information.

In approving Bluberi's arrangement, the court found that each of the above tests were met, and noted it was particularly determinative that, without proceeding with the litigation funding, unsecured creditors could not expect any recoveries on their claims.

The court also did not find the termination rights that were afforded the funder gave it too much discretion or undue influence over the litigation. These rights provided that Bentham could terminate the agreement if, "acting reasonably," it "ceases to be satisfied in relation to the Litigation" or "believes the Litigation and the Claims (or either of them) are no longer commercially viable".

The court was satisfied that in light of the amount of time and money invested by Bentham so far as well as its financial commitments, the funder had no intention of terminating the arrangement unless it perceived that it would not gain from it, and that such rights were not unreasonable.

Of apparent significance also was the fact that Bentham charged no fees or interest on the amounts funded, and therefore (as has been a criticism in some prior non-insolvency cases, where the funder's recoveries escalated over time) had no collateral interest in unduly drawing out the proceedings for the purpose of earning greater interest amounts or fees. It also meant that Bentham would only benefit in the event of a successful outcome to the litigation, meaning that Bentham was incentivized to—and had—expended significant resources in assessing the merits of the claim itself.

Seemingly implicit in this was that Bentham could not be accused of encouraging the bringing of an otherwise frivolous claim and on this point it is worth noting that the court mentions elsewhere the seriousness of the allegations at issue and that Bluberi had already shown clear interest in bringing a case against its former secured lender long before Bentham entered the scene.

Almost certain to be approved in the common-law provinces as well

Historically, litigation funding arrangements have been prevented in Ontario and the other Canadian common-law provinces in light of the influence of the common law doctrines of champerty and maintenance, which were directed at preventing third parties from instigating frivolous litigation; maintenance, being the act of giving assistance or encouragement to a litigant by a person who has neither an interest in the litigation nor any other motive that the law recognizes as a legitimate reason for interference. Champerty is a particular type of maintenance that arises when that third-party obtains a share of the proceeds of a successful outcome. Litigation funding

1 In a *Companies' Creditors Arrangement Act* proceeding, the monitor is an independent officer appointed by the court in an oversight role in connection with the proceedings.

arrangements were therefore viewed as per se champertous and historically considered void on that basis.

Notably and as mentioned by the court in *Bluberi*, Quebec is not a common law jurisdiction and so the issue of champerty and maintenance did not need to be considered. However there are very strong reasons to believe that funding arrangements would be approved in Ontario and the other provinces in an insolvency proceeding, and at this point the question is likely not *if* but *when*.

Firstly, litigation funding arrangements are already an established feature of the legal landscape of class action proceedings in Ontario, and there seems to be little reason why the principles that animate their approval in that context cannot be applied with only limited modifications in the insolvency context. The primary rationale for their approval in class actions cases is to enhance access to justice, and although the access to justice benefit may not be as persuasive in a commercial insolvency context as in the class action one, it is nevertheless an argument in favour of litigation funding's expansion in insolvency litigation. As evidenced by the example in *Bluberi*, an insolvent debtor or the party administering the debtor's estate may have a legitimate claim that the company may not have the resources to litigate without additional funding. Without such funding, that otherwise meritorious claim would go unpursued (or at least settled in less than optimum circumstances), and the debtor company, its creditors and other stakeholders would have no opportunity to benefit from the proper resolution of the claim.

However there are very strong reasons to believe that funding arrangements would be approved in Ontario and the other provinces in an insolvency proceeding, and at this point the question is likely not if *but* when.

Litigation funding was also recently approved for the first time outside of a class action context in Ontario in the private commercial litigation proceeding of *Schenk v. Valeant Pharmaceuticals International*, 2015 ONSC 3215. In that case, the court noted that as a preliminary matter, and although no prior cases had considered the issue in commercial litigation, it saw no reason why such funding would be inappropriate provided the arrangement was fair and reasonable as between the parties. Although the court initially declined to approve the funding arrangement at issue as fair and reasonable in light of the open-ended recoveries it granted the funder—the arrangement at issue provided that the funder was entitled to 30% of the recovery initially, increasing to 50% after 20 months, a 5% annual interest rate on all recoveries, and an additional 5% of the total proceeds for every 10% overage in the litigation budget—on a subsequent (unreported) decision dealing with a renegotiated agreement that capped recoveries at 50%, the court ultimately approved the agreement.

Finally such arrangements were arguably also pre-figured in the insolvency context in the CCAA proceedings of *Crystallex International Corporation*, 2012 ONSC 538 (aff'd 2012 ONCA 404). In the 2012 case, the Ontario Superior Court of Justice (Commercial List) approved a CDN$36 million DIP financing loan that entitled the lenders to, among other things, 35% of any recoveries on the debtor's sole remaining asset, a US$ 3.4 billion state-investor arbitration claim against Venezuela. Although the loan was approved under provisions of the CCAA dealing with the approval of security for interim DIP financing (the terms for which will frequently provide lenders with significant upside) and *not* considered as just a vehicle for financing the state-investor claim or in light of third-party funding case law, it does show that there was some precedent for approval of such arrangements as far back as 2011.

So in what circumstances then might such an arrangement in Ontario be approved, and what might it look like? It is necessarily unclear, particularly in light of the relatively brief reasons in *Bluberi* but the class actions case law as well as *Schenk* informed the court's decision in *Bluberi* and from a review of those cases, it is possible to identify several principles that parties seeking to enter into funding arrangements in the insolvency context should be mindful of:

- The primary rationale for approving a funding agreement is to promote access to justice, and as noted in *Bluberi*, the court must be satisfied that it is necessary to provide the would-be plaintiff(s) with access to justice.

- In determining whether an agreement is champertous, the ultimate standard is whether the funder is actuated by an improper motive and whether the agreement is fair and reasonable as between the funder and funded party.

  Whether a given arrangement is in turn fair and reasonable to the parties will depend on the circumstances of the litigation. Following *Schenk*, an arrangement that provides for steeply escalating or not clearly limited recoveries to the funder will very likely not be reasonable, though again in *Schenk*, a total recovery of up to 50% was permitted.

  Although it's hard to know where to draw the line for an upper limit—there are scenarios, such as where no recovery to creditors would otherwise be available but for the funding at issue or where the result of the litigation was relatively speculative, it is conceivable that higher limits could be permitted.

- Litigation funding agreements are not privileged in themselves because they do not communicate legal advice, however they may contain sensitive information that would provide tactical advantage in how the litigation would be prosecuted or settled (e.g., temporal variables of indemnity provisions, or sections relevant to litigation budget and trial stamina), and that can appropriately be sealed.

- A funding agreement should contain a term that the funder is bound by the deemed undertaking rule regarding any confidential information that comes into its possession. The funder should likely not be involved in settlement discussions, although it is reasonable for an agreement to require the borrower to share important developments, including offers to settle.

- The funding agreement should not compromise or impair the lawyer and client relationship, and the lawyer's duties of confidentiality or impair the lawyer's professional judgement and carriage of the litigation on behalf of the client and relevant stakeholders. Ontario courts have been reassured and approved agreements where the plaintiff is represented by seasoned and sophisticated counsel, and in the insolvency context this can be presumed to extend to the firm appointed as monitor or trustee in the case.

- On this same point, the agreement must not diminish plaintiffs' rights to instruct and control the litigation. Terms that would provide the funder with undue power vis a vis the funded party—such as a right to participate in settlement negotiations—may result in a finding that the agreement is unreasonable. That said, unilateral termination rights were not necessarily unreasonable and were permitted in both *Bluberi* and *Schenk*.

- A funding agreement will more likely be approved where the funder posts security for costs, and indeed this was a key factor in *Schenk* for permitting the funding termination rights that the agreement granted to the funder.

Bluberi appeal

In April 2018, the Quebec Court of Appeal granted leave to appeal to Bluberi's former secured lender and another creditor appellant based, in part, on their submission that the litigation funding arrangement at issue constituted a *de facto* plan of arrangement, and accordingly should be put to a vote in the same manner as a formal plan of arrangement under the CCAA. This contrasts with Bluberi's position that the funding at issue was not a plan or arrangement, but merely a tool towards the realization of the company's sole remaining asset, and one that, as noted by the court at the first instance, would not be realizable at all absent the impugned funding.

Timing of the appeal is currently unclear but Canadian insolvency professionals will be following the case closely to see how and whether third party litigation funding will continue to expand and gain purchase in the Canadian insolvency market.

Alex Schmitt is an associate in our Toronto office in the firm's financial restructuring and insolvency group.

Takata – anatomy of a complex cross-border restructuring

Shivani Shah

In the face of the largest recall in automotive history, Takata Corporation and its subsidiaries worldwide implemented one of the largest and most complex global restructurings seen in years. The restructuring was anchored by a chapter 11 case in the United States Bankruptcy Court for the District of Delaware, along with insolvency proceedings in Japan buttressed by ancillary proceedings in other jurisdictions.

The road to bankruptcy

Takata was one of the world's largest manufacturers and suppliers of automotive safety parts such as seat belts, airbags, steering wheels and child seats. Takata had operations in Japan, China, Germany, the United States, South Africa, and Mexico, among others, totaling 56 manufacturing plants in 20 countries with approximately 46,000 employees worldwide. Original Equipment Manufacturers ("OEMs") rely on suppliers like Takata to provide component parts in a complex supply chain that requires a stable production stream without interruption. Takata was one of a small number of large suppliers of safety parts, including airbags and related components, to OEMs large and small across the globe. As of 2014, Takata held 20 percent of the market share of the airbag business.

Takata's phase stabilized ammonium nitrate ("PSAN") inflators led to Takata's distress and ultimate downfall. Specifically, certain of Takata's PSAN inflators ruptured spewing shrapnel when deployed causing serious injuries in some cases and a number of fatalities.

These problems resulted in massive and wide ranging recalls by OEMs and governmental authorities, including in 2014, the United States National Highway Traffic Safety Administration ("NHTSA"). The recalls have grown to become the largest automotive recall campaign in history, involving the recall of more than 120 million airbags in over 55 million vehicles. The recalls triggered billions of dollars in contractual indemnity, reimbursement, and contribution claims asserted by OEMs against Takata as a result of the costs to remove and replace the recalled PSAN inflators.

There were also a multitude of individual and class action personal injury or wrongful death lawsuits as well as economic loss claims asserted against Takata and OEMs. Several states and US territories also brought lawsuits. While the lawsuits themselves were a significant strain on Takata's financial condition, this strain was dwarfed by the enormous OEM contractual indemnification claims against Takata for costs and expenses incurred by OEMs in carrying out the recalls.

NHTSA, in turn, imposed a $70 million civil penalty on Takata in November 2015, and imposed obligations on Takata to store and preserve the recalled PSAN inflators and phase out the manufacture of certain PSAN inflators.

The trouble for Takata only continued from there. Following an investigation by the FBI, US Department of Transportation, and the US Department of Justice, on February 27, 2017, Takata pled guilty to charges of wire fraud for providing false data to the OEMs related to the PSAN Inflators. In the criminal plea agreement, Takata agreed to pay $1 billion in restitution. This included: (a) a $25 million criminal fine to the US government, (b) $125 million in restitution to create an individual victim compensation fund, and (c) $850 million in restitution to create an OEM compensation fund, whom Takata admitted in the plea agreement had been defrauded.

Pursuant to the criminal plea agreement, Takata was required to remit the restitution funds by February 27, 2018, or face further criminal repercussions. Takata funded the $25 million fine and the $125 individual victim fund in 2017. However, it lacked sufficient resources on its own to fund the $850 million OEM restitution fund.

Restructuring a global footprint

In light of the cascade of troubles and complexities, a fifteen member informal OEM Customer Group was formed in 2016 to negotiate a restructuring and/or sale. The OEM Customer Group was comprised of the largest US, European, and Japanese OEMs including Fiat, Chrysler, Ford, General Motors, BMW, Daimler (Mercedes), Volkswagen, Honda, Nissan, and Toyota.

The only way Takata could meet its obligations under the criminal plea agreement was to sell its global business, which spanned five continents.

The massive indemnity liabilities to OEMs and overhang of individual and governmental liability emanating from Takata's PSAN inflators, however, made it difficult to achieve a market sale price absent protections for a buyer from present and future liabilities that could only be achieved in insolvency proceedings.

To further complicate matters, any sale pursued had to be consummated by February 27, 2018, the deadline in the plea agreement for Takata to fund all restitution payments.

Additionally, any sale of assets or the Takata enterprise would need to allow for a smaller, reorganized Takata to continue to operate its PSAN inflator business in order to meet its recall-related obligations to OEMs and of course to NHTSA, including the storage, preservation and ultimate disposition of the recalled PSAN inflators.

The first step to restructuring the global enterprise included coordinated insolvency filings in the United States and Japan, which would be supplemented with ancillary proceedings in other regions of the world.

On June 25, 2017, Takata's main US subsidiary TK Holdings Inc. and eleven of its US and Mexican affiliates ("US Debtors") each filed voluntary petitions under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. Takata's bankruptcy filings projected liability, including, but not limited to personal injury claims and OEM indemnifications, ranging from $10 billion to $50 billion.

On June 26, 2017, Takata Corporation, Takata Kyushu K.K., and Takata Service K.K. ("Takata Japan") commenced an insolvency proceeding under the Civil Rehabilitation Act in Tokyo, Japan.

Finally, on June 28, 2017, the US Debtors commenced an ancillary proceeding under the Companies' Creditors Arrangement Act (Canada), R.S.C. 1985, c. C-36, as amended, in the Ontario Superior Court of Justice.

Takata Japan also sought recognition of its proceeding by the United States Bankruptcy Court under Chapter 15 of the US Bankruptcy Code.

The coordinated proceedings aimed to implement a global transaction and asset sale of Takata's non-PSAN inflator business to a third party and to continue the PSAN inflator business as a reorganized Takata entity in order to provide OEMs with replacement parts for the recalls they were carrying out in addition to collecting, storing and disposing of the recalled PSAN inflators.

In November 2017, after months of pre- and post-bankruptcy negotiations, Takata ultimately finalized a global sale agreement and transaction with Key Safety Systems ("KSS"). KSS is a US auto components manufacturer that is owned by Chinese automotive supplier Ningbo Joyson Electronics Corporation. KSS agreed to sponsor Takata's restructuring efforts by purchasing substantially all of Takata's assets and operations through a globally coordinated restructuring effort. Specifically, KSS would acquire (a) the US and Mexican Takata assets pursuant to a court approved chapter 11 plan in the United States Bankruptcy Court, (b) the Japan assets through a court approved asset sale in the civil rehabilitation proceedings in Japan, and (c) certain other assets through various out-of-court transactions throughout Europe, Asia

The first step to restructuring the global enterprise included coordinated insolvency filings in the United States and Japan, which would be supplemented with ancillary proceedings in other regions of the world.

and other regions, for an aggregate purchase price of approximately $1.588 billion. KSS would acquire all of Takata's assets and business, except for operations that related to the manufacturing and sale of PSAN inflators.

In February 2018, the Japanese court approved the asset sale of Takata's Japanese business. On February 21, 2018, Bankruptcy Judge Brendan Shannon for the United States Bankruptcy Court for the District of Delaware, approved a chapter 11 plan that implemented a restructuring and sale of the US Debtors' assets to KSS. With both courts' approval, KSS was able to close on the global transaction in April 2018, less than one year after commencing the insolvency proceedings. The closing of the transaction in April 2018 enabled Takata to remit $850 million in restitution to the OEMs pursuant to Takata's criminal plea agreement (ahead of the deadline which had been extended by the US Department of Justice), further fund a bankruptcy trust to compensate individuals injured by Takata's PSAN inflators, and structure a reorganized Takata to carry out the PSAN inflator recalls and other obligations.

The road to a successful transaction, however, was anything but certain or simple. Takata needed financing from the OEMs to continue to operate while negotiating and reaching the closing of a sale and KSS required injunctions against claims and assurances that all issues with the US Department of Justice, specifically full payment of the $850 million OEM restitution fund, were addressed and resolved. Takata also needed to address the opposition and objections to the sale and chapter 11 plan, in particular, estate fiduciaries appointed to represent the interest of the current and future individual tort claimants.

First step: funding Takata and protecting OEM setoff rights as secured creditors

At the outset, Takata needed to figure out how it was going to fund its ongoing operations given that OEMs maintained enormous indemnity claims that could be offset or recouped against the hundreds of millions of dollars in payables owed to Takata at the very start of the insolvency proceedings.

In most automotive supplier restructurings, OEMs and suppliers execute what are commonly called accommodation agreements. An accommodation agreement is essentially a forbearance agreement that involves: (i) the OEMs, (ii) the supplier, and (iii) the secured lenders, if any. This agreement is put in place when a troubled supplier lacks the necessary funds to purchase materials to continue manufacturing products. Frequently, these agreements provide that OEMs will commit to advance payment in order to ensure liquidity, therefore, production.

Takata's restructuring, however, was significantly different from the usual automotive supplier restructuring given the size of the OEMs' indemnity claims. The OEMs' ability to setoff and recoup their indemnity claims had the potential to wipe out any payables owed to Takata as of the insolvency filings, at least in the US chapter 11 proceeding. In the US alone, as of the filing date, OEMs' payables approximated $285 million. It was imperative that Takata collected these receivables to operate until the global sale to KSS closed and to continue service for the ongoing recalls.

A solution was achieved that balanced the parties' rights and interests and was approved by the Bankruptcy Court. The OEMs agreed to provide the requisite financing by timely paying, and in some circumstances advancing payment on,

their payables. In the US chapter 11 case, the accommodation agreement, however, protected the OEMs by recognizing their setoff and recoupment claims as secured claims with resulting adequate protection, administrative claims and replacement liens consistent with debtor-in-possession and cash collateral protections given to secured creditors under the US Bankruptcy Code.

In short, the OEMs paid the payables owed on the petition date and were granted priority adequate protection claims and replacement liens on Takata's assets. Specifically, the priority claims and replacement liens were equal to the payables owed as of the petition date to the US Debtors – approximately $285 million. As discussed below, the OEMs' $285 million adequate protection priority claims and replacement liens were also instrumental in ensuring that the $850 million OEM restitution payment could be made by Takata at closing. Ultimately granting OEMs secured creditor status paved the way for funding Takata's operations during the restructuring process. The agreement also recognized the OEMs' rights as secured creditors – akin to debtor-in-possession lenders – while avoiding the need for what would have been a more expensive debtor-in-possession loan.

Next step: overcoming certain tort constituencies' objections

Garnering financing and entering into an accommodation agreement that recognized the OEMs' indemnity and setoff claims was only the first step. The Official Committee of Tort Plaintiffs, the legal representatives of individuals who sustained injuries, and the Future Claims Representative, along with certain other parties, were objecting to the sale to KSS and the chapter 11 plan.

A key aspect of the chapter 11 for Takata, KSS and the OEMs was to ensure that Takata could fully pay the $850 million OEM restitution fund. The various tort constituencies contested this aspect of the chapter 11 plan and sought to prevent the contribution.

After compressed and heavy litigation, the various parties reached settlements and incorporated them into the chapter 11 plan that facilitated a timely closing. The settlements also preserved the OEMs' right to the $850 million restitution fund, while simultaneously providing greater funding of the tort constituencies' unsecured claims.

The accommodation agreement provided the foundation for ensuring that the $850 million OEM restitution payment could be made by Takata.

Specifically, the chapter 11 plan recognized and incorporated the accommodation agreement granting the OEMs' priority claims and liens in exchange for payment of receivables owed to the US Debtors. Satisfaction of the OEMs' $285 million adequate protection claims and liens would be used to satisfy the US Debtors' required contribution to the OEM restitution fund. With the US Debtors' portion funded, the other global divisions of Takata were tasked to contribute the remaining funds to reach the designated $850 million required by the criminal plea agreement.

The chapter 11 plan also created a Personal Injury/Wrongful Death Trust ("Trust") for personal injury claimants. The Trust was funded in large part through a settlement whereby Takata would contribute a portion of the OEMs' general unsecured claim recoveries to the Trust. This additional funding enabled Takata to provide greater recoveries to individuals injured by the PSAN inflators. In addition, the plan included a channeling injunction that protected KSS from all liabilities related to Takata's PSAN inflators, including personal injury lawsuits. As would be expected, KSS, as buyer, required such protections as a condition of its purchase of Takatas. By creating this Trust and providing these protections, Takata and the OEMs were able to resolve the tort plaintiffs' objections and remove a considerable roadblock that could have resulted in significant pre- and post-plan litigation.

When the Bankruptcy Court approved Takata's chapter 11 plan on February 16, 2018, it did so with the support of all major US Debtors' creditor constituencies, including the Official Committee of Unsecured Creditors, the Official Tort Claimants Committee, the Future Claimants' Representative, as well as the OEMs.

Last step: Court rules that State Claims are dischargeable

In addition to the tort plaintiffs, various states and territories also opposed the chapter 11 plan and sale to KSS. Their objections stemmed from the large claims they asserted and contended were not dischargeable in the chapter 11 proceeding.

Hawaii, the US Virgin Islands, New Mexico, and Puerto Rico (collectively, the "States") individually filed complaints and unliquidated claims ("State Claims") in an amount estimated to be approximately $12 billion dollars. The State Claims asserted various causes of action, including but not limited to charges of unfair or deceptive acts or practices. The States claimed that these obligations were not dischargeable and hence could be pursued against reorganized Takata post-closing.

To prevent the sale to KSS from collapsing, Takata addressed the State Claims through litigation in the Bankruptcy Court in connection with approval of the chapter 11 plan. On February 14, 2018, the Bankruptcy Court issued an opinion determining that the State Claims were in fact dischargeable and were not excepted from discharge pursuant to the Bankruptcy Code. The States immediately appealed the Bankruptcy Court's ruling.

The strength and weight of the Bankruptcy Court's ruling, however, led to settlements with the States under which Takata allocated approximately $6.8 million of OEM general unsecured claim recoveries to the States as unsecured creditors. This final settlement enabled Takata and KSS to proceed smoothly to a closing without the overhang of any appeals.

Conclusion

Acknowledged to be one of the most complex restructurings in history, the global sale transaction was accomplished within a relatively expeditious 12 months from the commencement of the US and Japan insolvency proceedings. The transaction benefited all creditors and the driving public. First, the transaction avoided any supply chain disruptions by ensuring the continued and uninterrupted supply of automotive parts by Takata and KSS to OEMs. Second, the proceeds generated through the transaction enabled Takata to fund (a) the $850 million OEM restitution fund, and (b) a newly created bankruptcy trust to provide additional compensation to tort plaintiffs which supplemented the $125 million restitution award previously funded pursuant to Takata's plea agreement. Finally, the surviving reorganized Takata entity is able to continue providing replacement airbag parts to service ongoing PSAN inflator recalls.

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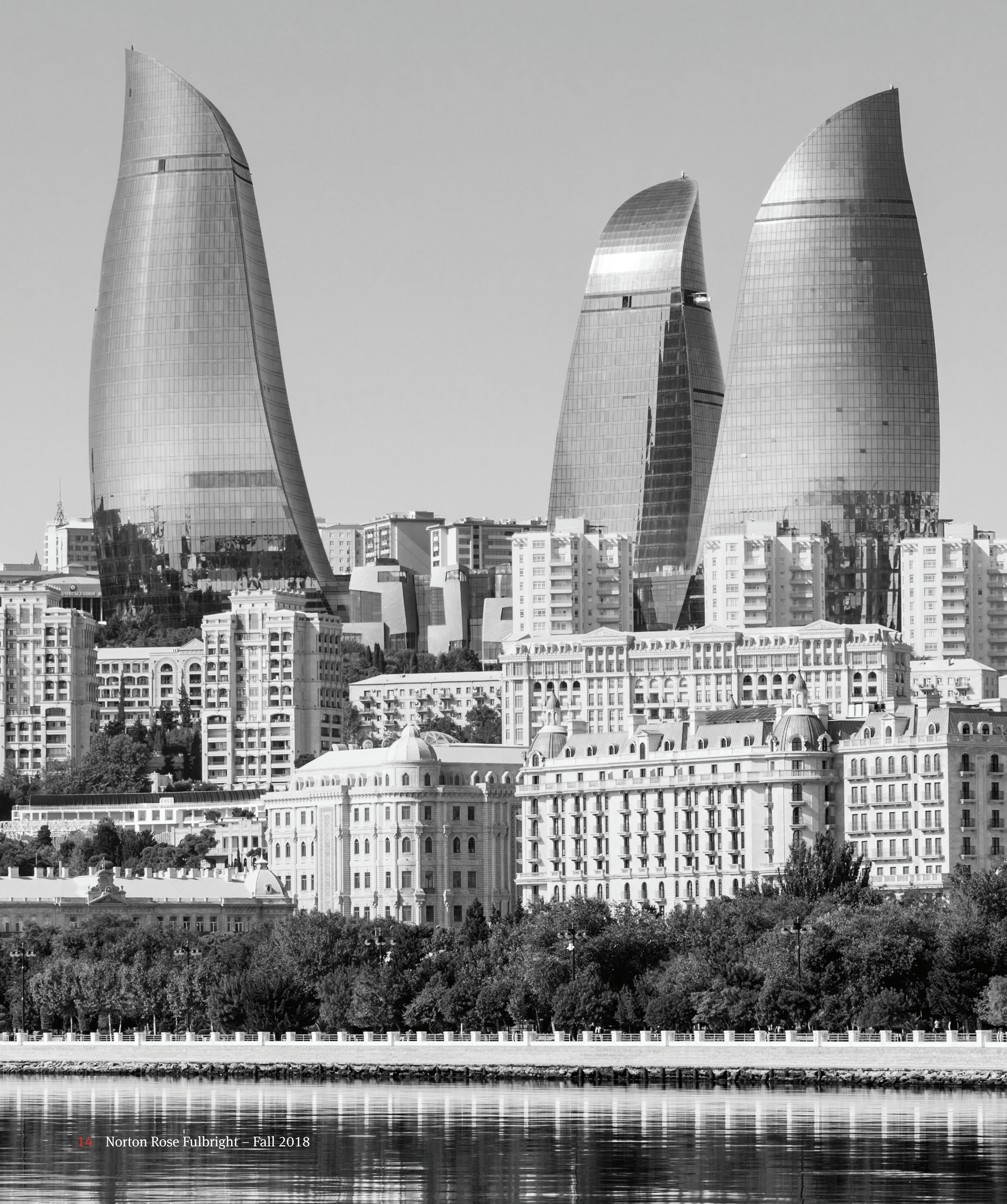

Cross-border restructuring conundrum: The current position for restructuring professionals following *The OJSC International Bank of Azerbaijan*

Bernie Walrut and Safiyya Khan

Earlier this year, the English High Court (EHC) delivered its judgment in *Gunel Bakhshiyeva (in her capacity as the Foreign Representative of The OJSC International Bank of Azerbaijan) v Sberbank of Russia & 6 Ors* [2018] EWHC 59 (Ch) (IBA Case) dismissing an application by the International Bank of Azerbaijan (IBA) for a permanent stay against creditors exercising their rights under English law governed contracts, contrary to the terms of a restructuring proceeding governed by Azeri law.

This decision by the EHC in respect of the IBA Case has reaffirmed the longstanding position that the discharge of an English law governed debt under the insolvency laws of a foreign jurisdiction outside of England and Wales is not a valid discharge of such debt, with the EHC noting that the request for a permanent stay, if granted, would operate the same as a discharge of a debt. In this respect the EHC followed the decision in *Antony Gibbs & Sons v Sociětě Industrielle et Commerciale des Mětaux (1890) 25 QBD 399* (Gibbs). The Court also held that the *Cross-Border Insolvency Regulations 2006* (CBIR) could not be used to modify the rule in Gibbs.

This article will consider the impact of the decision in the IBA Case on the legal position in Singapore, Hong Kong and Australia, including the key legal and practical implications of this judgment for restructuring professionals.

The rule in Antony Gibbs

The rule in Gibbs was summarised by Professor Ian Fletcher in *The Law of Insolvency (5th Edition)* at para 30-061 as follows:

> *According to English law a foreign liquidation—or other species of insolvency procedure whose purpose is to bring about the extinction or cancellation of a debtor's obligations— is considered to effect the discharge only of such of a company's liabilities as are properly governed by the law of the country in which the liquidation takes place or, alternatively, of such as are governed by some other foreign law under which the liquidation is accorded the same effect. Consequently, whatever may be the purported effect of the liquidation according to the law of the country in which it has been conducted, the position at English law is that a debt owed to or by a dissolved company is not considered to be extinguished unless that is the effect according to the law which, in the eyes of English private international law, constitutes the proper law of the debt in question.*

The facts in respect of Gibbs were as follows, Antony Gibbs entered into a contract to sell copper wire to La Société Industrielle Et Commerciale Des Métaux, a French company. The contract was expressed to be subject to the rules and regulations of the London Metal Exchange. The copper was to be delivered to an address in Liverpool and payment was to be made in cash in London against warrants. Before the order was completed by Antony Gibbs, La Société entered liquidation in France, by way of a judgment of judicial liquidation pronounced against it by the Tribunal of Commerce of the Seine.

Antony Gibbs commenced proceedings in England (it had proved in the liquidation in France) seeking an award of damages in respect of the loss sustained by it as a result of having to re-sell copper that the defendant was unable to accept. It was asserted by the defendant that the pronouncing of that judgment by the French tribunal, by the law of France, operated as a discharge of the defendants from liability to an action on the contracts.

The Court of Appeal unanimously rejected the argument of the defendant, holding that the parties did not agree to be bound by French law (including French insolvency law), as the governing law of the contract was English and that, similarly, a foreign composition is not regarded as effective unless it operates as a discharge according to the law of the debt.

The IBA case

The OJSC International Bank of Azerbaijan is the largest commercial bank in Azerbaijan. IBA's largest shareholder is the Government of Azerbaijan; its registered office and headquarters are situated in Baku, Azerbaijan and it is managed from its headquarters in Baku.

In May 2017, IBA encountered financial difficulties and entered into a voluntary restructuring proceeding in Azerbaijan, governed by Azeri law, to restructure approximately $3.34 billion of its financial indebtedness (**Restructuring Proceeding**). The purpose of the Restructuring Proceeding was to allow the IBA to restructure its debts.

On 5 May 2017, the foreign representative in the restructuring, Ms Gunel Bakhshiyeva, applied to the EHC seeking recognition of the Restructuring Proceeding as a foreign main proceeding.

On 7 June 2017 Ms Bakhshiyeva successfully obtained recognition of the Restructuring Proceeding as a 'foreign main proceeding' pursuant to the CBIR. The recognition order had the effect of imposing a moratorium on creditors, preventing them from commencing or continuing any action in England against IBA or its property (without the permission of the court) during the Restructuring Proceeding.

The restructuring plan proposed by IBA pursuant to the Restructuring Proceeding was approved by a substantial majority at a meeting of creditors in Azerbaijan on 18 July 2017. It was thereafter approved by the Nasimi District Court on 17 August 2017. As a matter of Azeri law, the plan became binding on all affected creditors, including those who did not vote and those who voted against the plan.

Subsequently the IBA made an application for recognition of the restructuring plan in England after it had received approval in Azerbaijan. It is this application which resulted in the decision in the IBA Case. The IBA sought orders that the moratorium imposed pursuant to CBIR be extended indefinitely which would, in effect, see English law governed claims being permanently compromised and released. The application was opposed by Sberbank and Franklin Templeton (**Respondents**), both of whom held English law governed claims against the IBA and, importantly, did not participate in the Azeri restructuring proceeding at all.

The central issue was whether an order indefinitely extending the moratorium under the CBIR would infringe the rule in Gibbs. The IBA argued no as there would be no 'discharge' of debt and that the moratorium would act as a 'procedural' bar to Sberbank and Franklin Templeton enforcing their claims. Sberbank and Franklin Templeton relied on the rule in Gibbs and argued that any permanent stay on their enforcement rights would operate as discharge of their claims.

The decision

Before proceeding, it is important to note that the decision of Hildyard J in the IBA Case is currently on appeal and due to be heard in late October 2018. The EHC held that:

> (1) the relief sought by the IBA was not purely procedural in nature as any such order (for a permanent stay) would have the effect of discharging Sberbank and Franklin Templeton's substantive rights under the English law governed contracts; and
>
> (2) the provisions of the CBIR do not enable English Courts to vary or discharge these substantive rights, with the effect that the court had no jurisdiction to make

the orders sought. Hildyard J went further by saying that even if the court had jurisdiction, he would not exercise his jurisdiction to make the orders sought because, among other reasons, the court was bound to apply the rule in Gibbs and procedural side-stepping was not appropriate (in place of following substantive provisions of English law, be they common law or statute).

The position in Hong Kong

The law, as it currently stands in Hong Kong, is that a debt governed by Hong Kong law cannot be discharged or compromised by a foreign insolvency proceeding unless, broadly speaking, the creditor participates in that foreign insolvency proceeding (see for example, *Hong Kong Institute of Education v Aoki Group* (No 2) [2004] 2 HKC 397).

As a result, the IBA Case has not disturbed the position in Hong Kong. As a result, it is likely to continue to be the case that:

> (1) a debt governed by Hong Kong law cannot be discharged or compromised by a foreign insolvency proceeding unless, broadly, the relevant creditor submits to the foreign insolvency proceeding; and
>
> (2) Hong Kong creditors' rights under Hong Kong law governed debt can only be compromised in a Hong Kong law governed process.

Accordingly, in circumstances where there is a foreign insolvency proceeding on foot, a parallel scheme of arrangement in Hong Kong (albeit adding to the cost of the restructuring process) is likely to be necessary in order to overcome uncertainty in respect of outlier creditor claims.

The position in Singapore

In July 2016, the Singapore High Court departed from the rule in Gibbs in *Re Pacific Andes Resources Development Ltd* [2016] SGHC 210. That proceeding involved an application for a moratorium on proceedings brought against debtor companies on the basis that the companies intended to enter into schemes of arrangement in Singapore. The relevant debts were governed by Hong Kong law.

The creditors argued, amongst other things, that the Court should not assume jurisdiction over the applications given that the debts were governed by Hong Kong law and that any discharge of the debts in Singapore would not be recognised in Hong Kong. The court rejected this argument on the basis that, if it has subject matter jurisdiction (assuming there is a sufficient nexus to Singapore to establish that jurisdiction, such as the location of assets in Singapore), then debts which are not governed by Singapore law may be compromised in a Singapore scheme of arrangement.

One of the arguments relied on by the debtor companies was that the Gibbs rule is in inconsistent with the modern approach of courts which recognises that there should be a universal approach to bankruptcy law (known as universalism). The basis for this rationale is that there should be one rule governing the distribution *pari passu* to creditors. The practical impact of this decision is that it will not be necessary to run parallel schemes in Singapore (subject to certain criteria – such as assets being located in Singapore) and will result in substantial cost savings for debtor companies.

The position in Australia

The decision in the IBA Case is not binding in Australia and has not been considered in any detail in Australia. Further, the decision in Gibbs has also only received obiter consideration in Australia. While the decision in the IBA Case is not binding in Australia it may be persuasive, particularly when an appeal decision in the IBA Case is delivered.

From an Australian perspective, specifically in the Asia Pacific region, where a proposed restructure seeks to compromise or release claims where some of those claims are governed by Hong Kong or English contracts, there will be significant complexity, given the ineffectiveness of any releases or compromises in Australia. The complexity will likely arise by reason of the need to commence parallel proceedings in other jurisdictions still following the rule in Gibbs.

Practical implications and solutions

In respect of the practical implications on cross border insolvency proceedings, the rule in Gibbs is likely to be relevant if a specific set of circumstances exists, such as English law governed contracts.

The purpose of the Restructuring Proceeding was to allow the IBA to restructure its debts.

It is an exception to the Gibbs rule if the relevant creditor submits to the foreign insolvency proceeding (i.e., if the creditor elects voluntarily to participate in the restructuring proceeding). As a result, negotiations with the creditor to encourage them to participate in the restructuring proceeding could be helpful. However in practice it is difficult to see why a creditor would agree to this. Even if the creditors that hold English law claims elect not to participate, presence in the home jurisdiction of the restructuring proceeding (through a branch office or otherwise) may enable the debtor to seek an injunction or similar relief from the home jurisdiction court against the creditor to compel them to submit to the plan.

Even if the creditor does not voluntarily submit to, or is not compelled to participate in, the voluntary restructuring proceeding, practically, it would only be worthwhile for the creditor to pursue such a claim in England in circumstances where there are assets of the foreign debtor in England.

Despite the fact that the Gibbs rule arose out of facts which clearly involved a liquidation scenario, in the IBA Case the court accepted that the Gibbs rule may have limited scope in the context of a foreign liquidation (given creditors would be unable to execute against the debtor's assets in England). Arguably, *Re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852 is an example of a case which shows that a foreign proceeding by way of terminal liquidation (as opposed to restructuring as a going concern) seems more likely to be supported by the English courts.

Nonetheless, it is necessary to consider the practical implications of the Gibbs rule in Australia, particularly with respect to the effectiveness of a restructuring in Australia that involves releases of claims against the debtor governed by foreign laws (especially England and Hong Kong), which may be of significant importance in a cross border restructuring. One particular concern is that the IBA decision may be relevant to an Australian court's discretion to approve a scheme (i.e., ineffectiveness in England would be a factor against approving the scheme – see for example: *Re Reodenstock GmbH* [2011] EWHC 1104 (Ch). A potential solution may be for the debtor to run a parallel English scheme of arrangement (although, as mentioned earlier, there may be significant costs associated with this).

Despite all of the concerns raised in the commentary about the archaisms of the Gibbs rule, the decision by the EHC to follow the Gibbs rule in the IBA Case is likely to be seen favourably by creditors, who can take comfort in the fact that the law currently stipulates that foreign insolvency processes cannot be used to modify or compromise English law governed claims. Accordingly, creditors seeking certainty may want to adopt English law as the governing law for cross border transactions.

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The English Court's power to appoint provisional liquidators over foreign companies in urgent cross-border insolvencies

Simon Jerrum

In *HMRC v Rochdale Drinks Distributors Ltd [2012] 1 BCLC 748*, Lord Justice Lewison described the appointment of a provisional liquidator as "*one of the most intrusive interim remedies in the court's armoury.*" This is especially so where the Court appoints a provisional liquidator over a company outside the jurisdiction. This article considers the circumstances in which the English court will exercise its discretion to appoint a provisional liquidator over a foreign company. As will be seen, the Courts will generally only do so in exceptional and extreme cases, where there is an urgent need to protect assets pending the hearing of the winding up petition.

The grounds for the appointment of a provisional liquidator

Section 135(1) of the Insolvency Act 1986 provides that the Court may appoint a provisional liquidator over a company at any time after the presentation of a winding up petition. The provisional liquidator's primary responsibility will be to preserve assets pending the making of a winding up order (at which point a liquidator will be appointed to take steps to realise those assets), and will have the powers and functions set out in the order appointing them.

Any creditor of the company can make an application for the appointment of a provisional liquidator. In *Rochdale Drinks*, the Court set out a two stage approach that will be taken when considering whether a provisional liquidator should be appointed. *First*, the Court must be satisfied that, on the hearing of the winding up petition, an order for winding up is likely to be made. *Second*, assuming the first stage is satisfied, the Court must be satisfied that it is right, in all the circumstances, that a provisional liquidator is appointed (i.e., the Court considers whether it should exercise its discretion to appoint a provisional liquidator).

The Court's jurisdiction to wind up foreign companies

As the applicant must show that it is likely that a winding up order will be made at the hearing of the petition, a provisional liquidator can only be appointed over companies which the English court has jurisdiction to wind up. Many of the cases dealing with the appointment of provisional liquidators over foreign companies therefore involve a careful analysis of whether or not the Court has jurisdiction to make a winding up order. As Lord Justice Peter Gibson noted in *Re Titan International Inc [1998] 1 BCLC 102*, for an English court to wind up a foreign company which has done nothing whatsoever in the jurisdiction would be "*a giant, impermissible and unjustified extension of the jurisdiction of the English court.*"

At present, the jurisdiction of the English court to wind up a foreign company is subject to the Recast EU Regulation on Insolvency Proceedings (2015/848). For companies which have their centre of main interests ("COMI") in an EU member state, the country in which the COMI is located has exclusive jurisdiction to open "main" insolvency proceedings. There is a rebuttable presumption that the COMI is located in the jurisdiction in which the company's registered office is located. "Secondary" proceedings in another jurisdiction may only be opened if the debtor "possesses an establishment" in that jurisdiction (and may relate only to the assets of the debtor situated in that jurisdiction).

An application for the appointment of a provisional liquidator is often made urgently, in order to prevent dissipation of assets or the destruction of books and records.

Subject to the rules in the Recast EU Regulation in relation to companies with their COMI in another EU member state, the jurisdiction of the English courts to wind up foreign companies is part of the Court's jurisdiction over unregistered companies under section 221 of the Insolvency Act 1986. Section 221(5) provides that the circumstances in which an unregistered company may be wound up are:

1. If the company is dissolved, or has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs;

2. If the company is unable to pay its debts; or

3. If the court is of the opinion that it is just and equitable that the company should be wound up.

In *Re Real Estate Development Company [1991] BCLC 210* the Court set out the grounds on which a foreign company can be wound up in England:

1. There must be a sufficient connection with England and Wales. In *OJSC Oil Company v Abramovich* the Court said that an asset within the jurisdiction would not automatically be considered a sufficient connection, but in that case a Commercial Court claim for US$2 billion constituted a sizeable asset forming a sufficient connection with England and Wales.

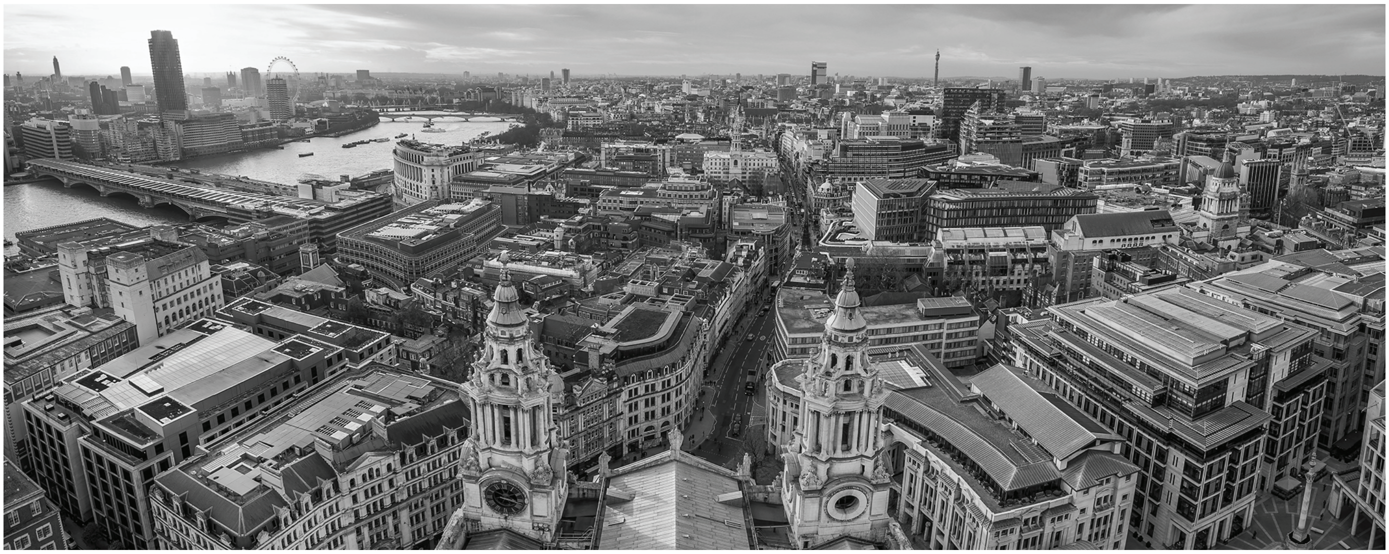
2. There must be a realistic possibility of benefit to those applying for the winding up order. In *Buccament Bay Limited and Harlequin Property (SVG) Limited [2014] EWHC 3130 (Ch)*, the English court refused to make a winding up order in respect of a company incorporated in St Vincent and the Grenadines as there was a "*perfectly satisfactory winding-up process*" available in the company's jurisdiction of incorporation and so there was no reasonable possibility of the petitioners deriving a benefit from a winding up in England and Wales.

3. One or more persons interested in the distribution of a company's assets must be persons over whom the Court can exercise jurisdiction. The fact that a creditor has presented a petition is not in itself sufficient. However, in *Stocznia Gdanska SA v Latreefers Inc (No 2) [2001] 2 BCLC 116* the petitioning creditor had the benefit of an English judgment debt (which involved submission to the jurisdiction) and it was still the plaintiff in ongoing proceedings meaning that the submission to the jurisdiction was continuing. The petitioning creditor was therefore held to have submitted to the Court's jurisdiction and was a person over whom the Court can exercise jurisdiction.

Each of these conditions must be satisfied in order for a foreign company to be wound up in England as an unregistered company under section 221. However, following the decision in *Re Titan International*, if the company is being wound up pursuant to section 221(5)(c) (i.e., if the Court is of the opinion that it is just and equitable for the company to be wound up), there only needs to be a sufficient connection with England and Wales.

The Court's exercise of its discretion to appoint a provisional liquidator

If the Court is satisfied that a winding up order is likely to be made it will then consider whether it is right, in all the circumstances, that a provisional liquidator is appointed.



The English courts exercise their discretion in this regard carefully and do not make a decision to appoint a provisional liquidator lightly. There are potentially dire consequences for the company concerned in the appointment of a provisional liquidator, and it is likely to be fatal to the company continuing to operate as a going concern. In *Rochdale Drinks*, Lord Justice Rimer recognised that an appointment of a provisional liquidator is a very serious step for a Court to take and that it is almost inevitable that as a result of such an appointment the underlying business of the company is likely to cease and that damage is likely to be irremediable. Similarly, in *HMRC v Winnington Networks Ltd [2014] EWHC 1259 (Ch)*, the Court held that the appointment of a provisional liquidator is a most serious step and should be the subject of anxious consideration. There must be a risk to assets or a potential loss or destruction of a company's books and records, or alternatively it must be in the public interest for a provisional liquidator to be appointed.

An appointment of a provisional liquidator is therefore usually only made in a clear case of insolvency. For example, in *Re Treasure Traders [2005] EWHC 2774 (Ch)*, the company was carrying on a business that was unlawful under the Fair Trading Act 1973 as well as being an unlawful lottery and it was "*a virtual certainty*" that it would be wound up. It was therefore held to be appropriate to appoint a provisional liquidator to secure the company's assets and prevent further unlawful activity.

The concern as to potentially severe effects on the company is especially pertinent in the case of the appointment of a provisional liquidator over a foreign company, where the Court is exercising extraterritorial jurisdiction. Usually the company is involved in misconduct, although it is not necessary to show a deliberate making away with the assets but rather a serious risk that the assets may not continue to be available to the company and distributed other than rateably amongst its creditors. In *Re a company (No 003102 of 1991), ex parte Nyckeln Finance Co Ltd [1991] BCLC 539*, it was held that assets of a company incorporated in Guernsey were in jeopardy and, as the aim of the provisional liquidator was to get in assets, the appointment of a provisional liquidator would prevent assets from being dissipated.

Part of the provisional liquidator's function will be to obtain control of books and records so that he can engage in all necessary investigations of the company's transactions. In *Rochdale Drinks*, the circumstances justified the appointment of a provisional liquidator because there were questions as to the integrity of the company's management and the quality of its accounting and record-keeping function.

In appropriate cases, therefore, the English court will exercise its discretion to appoint a provisional liquidator over a foreign company. However, that jurisdiction is exercised very carefully.

Procedural issues involved in any application for the appointment of a provisional liquidator

An application for the appointment of a provisional liquidator is often made urgently, in order to prevent dissipation of assets or the destruction of books and records. Insolvency Rule 12.10 provides that the Court may hear an urgent application immediately with or without notification to (or the attendance of) other parties.

Therefore, whilst notice of the application is normally given to the company, it is possible to make an application for the appointment of a provisional liquidator without notice (particularly where there is a risk of the company taking steps to defeat the purpose of the appointment). In *HMRC v Winnington Networks* the Court said that an application without notice needs to be justified by exceptional circumstances, although in that case the without notice applications were properly made and justified having regard to the apparent lack of integrity in the management and the ease with which funds could be moved offshore.

Where the application is made without notice, there are two important points to bear in mind.

First, the applicant will need to give full and frank disclosure of any and all matters which may affect the making of the order. In *OJSC v Abramovich* the Court held that the extent of the non-disclosure was so substantial that it would have been sufficient to set aside the order appointing the provisional liquidator. In other cases, the Court might deal with a breach of the duty of full and frank disclosure by other means even where the Court is entitled to discharge the ex parte order, for example by continuing the order or making a new order on terms (see *Brink's Mat Ltd v Elcombe [1988] 1 WLR 1350*). It is also possible for the Court to deal with any breach by way of an adverse costs order (*NML Capital Ltd v Republic of Argentina [2011] UKSC 31*).

Second, the applicant will ordinarily be required to give a cross-undertaking in damages to compensate the company for any loss or damage that is caused by the order if it is later determined that it should not have been made. This is a potentially substantial liability for the applicant in cases such as the appointment of a provisional liquidator where the company may cease to operate as a going concern. In *Abbey Forwarding v HMRC [2015] EWHC 225 (Ch)*, an inquiry as to the damages suffered by the company as a result of the appointment of a provisional liquidator was ordered in relation to a cross-undertaking in damages given by HMRC. However, in *Rochdale Drinks*, Lord Justice Lewison noted that, "*[i]f a business is shut down wrongly, the cross-undertaking is unlikely to provide adequate compensation to the company concerned, let alone to the employees who will have lost their jobs and to whom no cross-undertaking will usually have been offered.*"

If a provisional liquidator is appointed, his or her appointment comes to an end automatically on the date of any winding up order made in relation to the company. It could also come to an end when the winding up petition is dismissed, or by order of the Court upon an application by the provisional liquidator or anyone else entitled to apply for their appointment.

Conclusion

The English court is willing, in appropriate cases, to appoint a provisional liquidator over a foreign company if it has jurisdiction to do so. However, the Court will consider carefully the circumstances of each particular case in order to determine whether it should exercise its discretion to appoint a provisional liquidator.

Whilst appropriate cases for the appointment of a provisional liquidator are still unusual, as Mr. Justice Harman noted in the *Nyckeln Finance* case as far back as 1991, "*as communications, transport and so on become easier and faster so such cases become less highly unusual.*" The increase in the number of appointments of provisional liquidators over foreign companies is therefore only likely to increase.

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Post-Detroit–are there alternatives for distressed municipalities to restructure?

Lawrence A. Larose and Samuel S. Kohn

The City of Detroit's historic bankruptcy is a case study of how a severely distressed municipality can restructure massive amounts of debt, reduce pension obligations, resurrect its economy and return to the municipal bond market through the use of Chapter 9 of the bankruptcy code. Detroit's recovery could not have happened without the acquiescence and assistance of the State of Michigan. Indeed, some would argue that Michigan was the chief architect of Detroit's bankruptcy by its appointment of Detroit's emergency manager who filed Detroit's bankruptcy case. However, since Detroit's bankruptcy, some states have chosen a different path to deal with their distressed municipalities attempting instead to restructure through legislation and negotiations with key stake-holders. Two such distressed municipalities: Atlantic City, New Jersey and Hartford, Connecticut, have recently restructured outside of Chapter 9. It remains to be seen whether such alternatives will have lasting long-term success.

1. Atlantic City, New Jersey

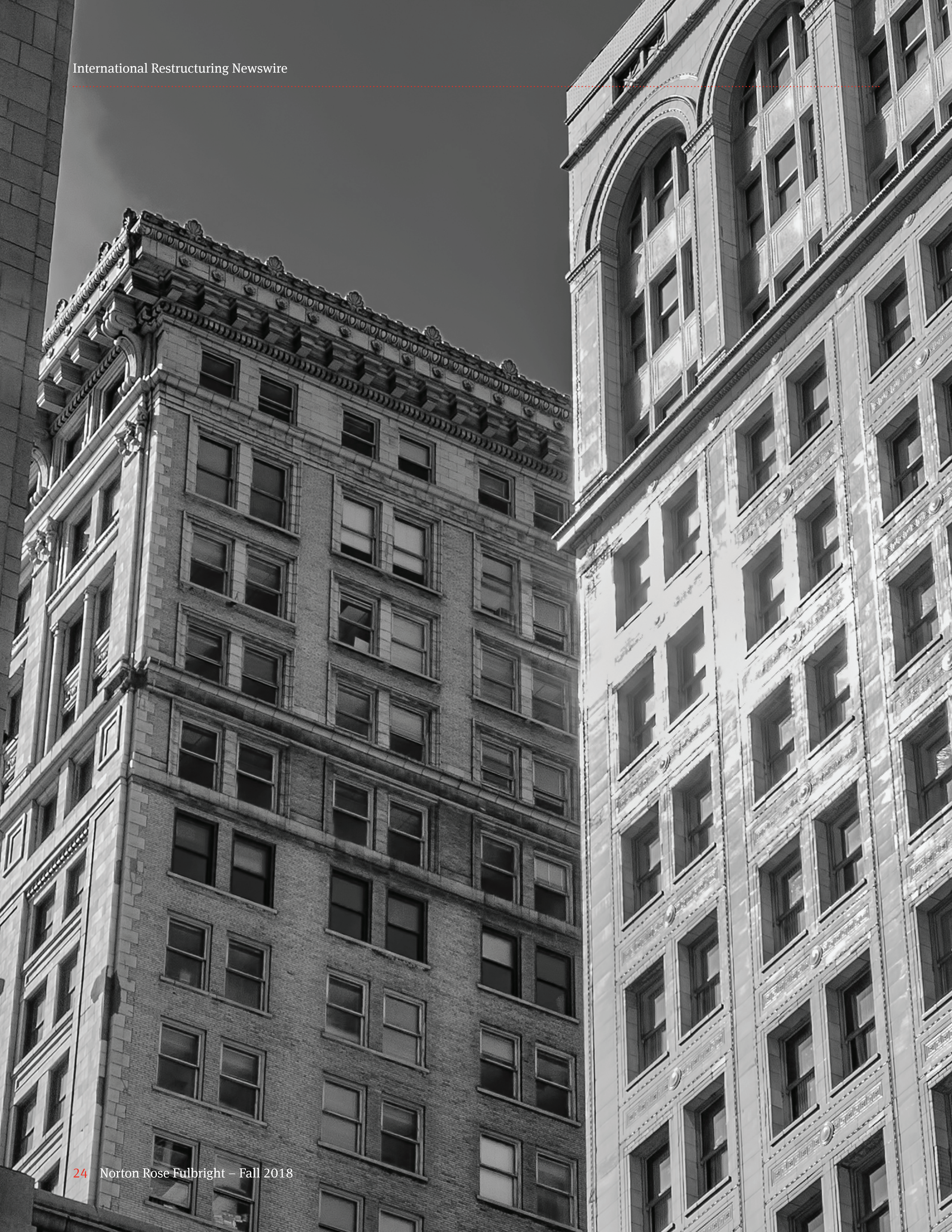
The fall of Boardwalk Empire

Once called "America's Playground," Atlantic City, New Jersey, faced a severe downturn post- World War II through the 1960's. In an effort to revitalize the city, and at the same time produce new sources of state revenue, New Jersey voters in 1976 approved a referendum allowing casino gambling in Atlantic City. Casino gambling triggered an economic boom in Atlantic City for more than three decades. But, as a result of regional competition and the Great Recession, several casinos failed causing Atlantic City's tax base and tax revenue to precipitously decline. Beyond steep declining revenues, Atlantic City faced several lawsuits brought by casinos for hundreds of millions of dollars in tax refunds as a consequence of declining property values and assessments. By the end of 2014, bankruptcy or state takeover were openly discussed and hotly debated.

Politics as usual

Although New Jersey's statutes include well-defined state takeover and municipal bankruptcy provisions, either option or any other plan for the recovery of Atlantic City required the political will of all levels of government. Local officials bitterly resisted talk of a state takeover. In early 2015, by executive order, then-Governor Christie appointed an emergency manager team for Atlantic City, with substantial experience in Detroit's bankruptcy. Soon thereafter, the credit rating agencies lowered Atlantic City's general obligation bond ratings to junk status. In August 2015, with input from creditor constituencies, New Jersey enacted changes to its Municipal Qualified Bond Act granting a statutory lien for certain municipal bonds secured by a pledge of state aid revenues appropriated for local municipalities. Notwithstanding the new legislation, by the end of 2015, it was clear that market access for Atlantic City was closed.

The political debates were not quieted. Governor Christie proposed a state takeover of nearly all of the city's operations, including the right to deal directly with labor unions, dissolve city agencies and sell off city assets. Atlantic's City's mayor and certain state legislators proposed an alternate plan that included substantial state aid and loans, but conditionally allowed the city to retain control. Significantly, neither side offered bankruptcy as a solution, notwithstanding Detroit's apparent successful restructuring under Chapter 9. Officials expressed concerns that an Atlantic City bankruptcy would



not only be bad for Atlantic City but for the state and all its municipalities as well since borrowing costs would increase going forward. By early 2016, the emergency manager team had resigned without developing a plan that was accepted by the state or the city.

Finally a compromise

In May 2016, New Jersey enacted the Casino Tax Property Stabilization Act (Stabilization Act)[1]. The Stabilization Act exempts Atlantic City casino gaming properties from property taxation and instead imposes an annual "Payment-in-Lieu of Taxes," seeking to establish a steady stream of revenue for Atlantic City over ten years. The goal of the guaranteed tax payments is to stabilize Atlantic City's finances, while removing the burden and expense of defending against the casinos' property tax appeals. Other provisions of the Stabilization Act include, a mandatory payment by casinos of $120 million for 2017, requirement by Atlantic City to formulate fiscal recovery plans approved by the Department of Community Affairs (DCA) and continued direct state oversight via an appointee of the DCA.

Is Atlantic City stabilized?

Although recent reports indicate that Atlantic City's casinos and the city's general economy are faring better, Atlantic City's recovery remains slow. The city's general obligation bonds are still rated below investment grade, but in 2017 it did manage to sell $68 million of tax appeal refunding bonds with the enhanced protections of the revised Municipal Qualified Bond Act. Most recently, $49.2 million in deferred contribution refunding bonds were sold by the DCA (rather than the city itself) to finance pension and healthcare contributions to Atlantic City's employees that were deferred in 2015 during the city's budget crisis.

2. Hartford, Connecticut

No longer "Insurance Capital of the World"

For almost two centuries many of the largest insurance companies were headquartered in Hartford, Connecticut, contributing to Hartford's sustained economic growth until the 1950's. As the insurance companies grew, so did the demand for its labor force making Hartford a popular place to live and work. However, by the end of the twentieth century as a result of mergers and corporate downsizing few insurance companies remained in Hartford, causing a steep decline in insurance industry employment and related tax revenues. The post -World War II flight to the suburbs didn't help, as Hartford experienced a population decrease of over 30% from 1950 until 2014, exacerbating Hartford's declining tax base.[2] These events coupled with Hartford's reliance on state payments to cover the city's tax-exempt properties, led to rising deficits and underfunding of the city's pension funds, without the ability to access the capital markets. By the beginning of 2017, Hartford's mayor demanded more that $50 million in state assistance to balance the city's budget. Soon thereafter, credit rating agencies downgraded the city's general obligation debt ratings to "junk" status.

Spring, Summer and Fall: no state budget

For the first ten months of 2017, Connecticut state legislators quarreled over its state's budget. One major sticking point was to what extent, and by what means, should state assistance be provided to Hartford. The stalemate surpassed the state's budget deadline of June 30, 2017, forcing Connecticut to operate without a budget for an unprecedented 123 days. During the summer and fall of 2017, city officials hired bankruptcy professionals and wrote to Governor Malloy that without a state budget with sufficient assistance to Hartford, it would seek permission from the Governor to file for bankruptcy, as prescribed by state law. Throughout this time, major creditors actively engaged state legislators and government officials, proposing restructuring alternatives and legislative solutions.

Finally a budget: A legislative compromise

After months of intense and round-the-clock negotiations, in late October 2017, legislative leaders of both parties announced a compromise two-year budget for the state that was developed without input from the Governor's office. After the Governor threatened a veto, the new state budget was finally enacted on October 31, 2017, incorporating suggestions from creditors.

The new state budget, in the form of Senate Bill No. 1502[3] (Bill 1502), provides for a new state-supervised system for distressed municipalities by establishing the Municipal Accountability Review Board (MARB). The MARB is empowered with varying degrees of fiscal oversight and control of distressed municipalities, depending on a municipality's classification (tiers I-IV). Distressed municipalities under MARB supervision, including Hartford, are required to submit long-term recovery plans.

1 N.J. Senate Bill No. 1715.

2 See Hartford, Connecticut: A Demographic Report (2014).

3 June Special Session Public Act No. 17-2.

Notably, Bill 1502 established two new forms of state assistance for Hartford. First, the legislation set aside $28 million for each of fiscal years 2017-18 and 2018-19, for general aid to fiscally distressed localities. Legislative leaders of both parties announced that they anticipated Hartford would receive approximately $20 million of the $28 million to be distributed. Second, at the discretion of the MARB and satisfaction of certain conditions, Hartford would be able to receive up to $20 million in the form of "contract assistance" for fiscal 2017-18, with terms to be negotiated between the city and the MARB. In addition, Bill 1502 empowered the state to, under certain conditions, grant other forms of contract assistance to tier III and IV municipalities, including the assumption of all or a portion of the municipality's debt service obligations.

Spring forward: more assistance more controversy

On March 27, 2018, citing Bill 1502, the state entered into a contract assistance agreement with the city and assumed approximately $550 million of Hartford's debt service payments of its general obligation bonds. Notably, the contract assistance agreement provides for its termination if Hartford requests permission from the Governor to file a Chapter 9 bankruptcy case. Soon after the execution of the Hartford contract assistance agreement, the credit ratings agencies lifted the city's general obligation bond credit ratings from "junk" status to strong investment grade. At the same time, however, S&P downgraded the state's general obligation bonds from A+ to A.

State legislators, Republicans and Democrats alike, immediately cried foul; insisting that assumption of $550 million of Hartford's debt was not part of the legislative compromise that resulted in the enactment of Bill 1502. Connecticut's cities criticized the agreement as an unfair bailout as well. The groundswell of criticism led to a new bill in the state legislature, Bill No. 528, limiting Hartford's assistance to five years unless extended by the legislature, and removing the executive branch's unilateral power to enter into contract assistance agreements in the future. Although Bill 528 passed both the state assembly and senate by substantial margins, on June 14, 2018, the Governor vetoed the "bailout limitation" bill. As the legislature did not have the necessary votes for an override, the Governor's veto was sustained on June 25, 2018.

3. State assisted versus Detroit: sustained restructurings?

It is axiomatic that consistent market access is crucial to a governmental entity's ability to be self-sufficient and is the best indicator of whether a municipality is genuinely restructured for the long-term. Several months after Detroit's bankruptcy, credit rating agencies upgraded the Detroit's' credit rating to investment grade. Recently, a few weeks after Michigan officials announced that Detroit had emerged from state oversight, city officials indicated that Detroit has plans to issue general obligation debt based on its own full faith and credit, and would propose a plan to streamline their debt-service obligations over the next ten years.

In contrast, Atlantic City's credit ratings are still below investment grade. While New Jersey's state-assisted solution arguably provides Atlantic City with stable revenues and substantial state assistance, Atlantic City still needs to demonstrate to the capital markets that it has the economic wherewithal to incur general obligation debt on its own, and most importantly that it can timely repay all its debts.

Hartford's recent restructuring of all of its general obligation debt demonstrates that with the requisite political will and political power states can formulate solutions to assist troubled municipalities to restructure without bankruptcy. However, such fixes are intensely political in nature and are entirely dependent on the will of government officials and representatives. But for the veto by a lame duck governor, Hartford's long-term restructuring was nearly thwarted by legislation

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proposed a mere six months subsequent to the enactment of Bill 1502. Politicians' and public support for Hartford's bailout could erode as time passes. Political proponents of the "bailout," however, can point to Hartford's current strong credit ratings which arguably benefit the state and other Connecticut municipalities for continued support of the city's restructuring. Conversely, opponents can argue that, notwithstanding the state bailout, Hartford's pensions remain substantially underfunded.

Only time will tell if New Jersey and Connecticut have succeeded in their goals of a sustained restructuring for Atlantic City and Hartford.

The opinions expressed are those of the authors and do not necessarily reflect the views of Norton Rose Fulbright US LLP, its clients or any of their respective affiliates. Members of Norton Rose Fulbright US LLP represented and still represent parties actively involved in the restructurings discussed herein.

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