

International Restructuring Newswire

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

First Quarter 2020

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Published by Norton Rose Fulbright – First Quarter 2020 – Issue 9

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To our clients and friends:



As we start the new year, it is worthwhile to take a look back at what was driving the restructuring environment in 2019. The world economies were favorably impacted by supportive monetary policy in the United States and other countries and buoyed as well by strong consumer and government spending. The most negative factors were the uncertainty created by the lack of resolution of Brexit in the UK and the continued trade tensions between the US and China. These issues are likely to persist in the new year. The take-away for 2019 was that no recession occurred (at least in the US) but growth in gross domestic product globally slowed and slipped to 2.3% from 3% in 2018.

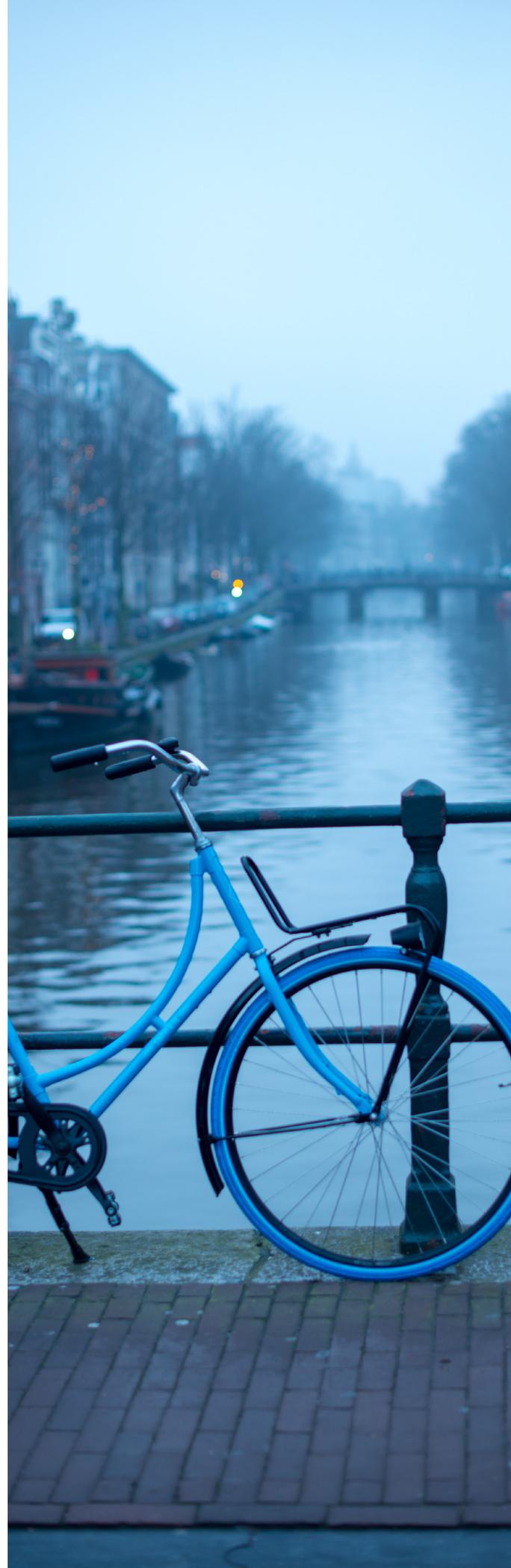
What to expect in 2020 is anybody's guess. Political uncertainty abounds, with impeachment proceedings and a presidential election looming in the US and instability and tension globally, particularly now in the Middle East. At the very least, US chief executives are getting worried about a recession. As recently reported in *The Wall Street Journal*, according to a recent survey, "fear of economic decline" topped their list of concerns for 2020. CEOs reported uncertainty around a host of issues, from trade to climate change, which has exacerbated their anxiety.

This global economic uncertainty for 2020 only makes it more imperative to stay on top of restructuring developments throughout the world. In this issue we look at restructuring changes across the Norton Rose Fulbright network: in the Netherlands, Canada, Australia and the UK, not to mention an article on further revisions to India's bankruptcy laws.

All the best for 2020 and enjoy the issue.

Howard Seife

Global Head
Bankruptcy, Financial Restructuring and Insolvency



In the news

UNCCA: UNCITRAL National Coordination Committee for Australia

Brisbane and Hobart, Australia:
October 23, 2019

Scott Atkins and John Martin presented on “25 years of cross border insolvency law reform” at the UNCCA: UNCITRAL National Coordination Committee for Australia’s annual UN Day Lecture.

New York State Bar Association

Tokyo, Japan: November 8, 2019

David Rosenzweig spoke on a panel at the New York State Bar Association’s International Section Global Conference in Tokyo, Japan. The Panel was comprised of US and Japanese lawyers discussing cross-border insolvencies with focus on the Takata Corp. global restructuring in the US, Japan and elsewhere.

The University of Texas School of Law

Austin, TX: November 15, 2019

Ryan Manns presented as a panelist on “Health Care Bankruptcies - How to Diagnose and Treat These Patients” at The University of Texas School of Law 38th Annual Jay L. Westbrook Bankruptcy Conference.

INSOL International One Day Seminar

Mexico City, Mexico: February 13, 2020

Howard Seife is the International Educational Co-Chair for INSOL International’s One Day Seminar in Mexico City. The conference will cover a wide range of topics in insolvency in Latin America.

American College of Bankruptcy Induction

Ryan Manns has been invited to join as a Fellow in the American College of Bankruptcy. He is one of 31 new Fellows being recognized for their professional excellence and exceptional contributions to the bankruptcy and insolvency field. The College now has over 800 Fellows, each selected by a Board of Regents from recommendations of the Circuit Admissions Councils in each federal judicial circuit and specially appointed Committees for Judicial and International Fellows. The induction ceremony in honor of the new Fellows will take place in Washington, DC in March of 2020.

INSOL World

Francisco Vazquez’s article “US Bankruptcy Court Provides Guidance on the COMI Analysis of Members in a Group” was recently published in the Q4 2019 edition of *INSOL World* (of which Mark Craggs is co-editor). The article considers the bankruptcy court’s decision in *Constellation Oil Services Holding S.A.* under Chapter 15 of the US Bankruptcy Code.

The implementation of the EU Restructuring Directive in the Netherlands: the “WHOA”

Koen Durlinger

On 5 July 2019, the Dutch legislative proposal on the Act on confirmation of private plans (*de Wet homologatie onderhands akkoord*; the “WHOA”) was submitted to the Dutch House of Representatives. The WHOA will, once enacted, represent the introduction of an effective restructuring mechanism in the Netherlands for the first time, with concepts similar to UK schemes of arrangement and US chapter 11 procedures. Enactment is expected to take place in 2020.

The first restructuring mechanism in the Netherlands outside of formal insolvency proceedings

The WHOA aims to improve the reorganisation capabilities of companies that have viable businesses, but carry too much financial debt. Currently, no restructuring mechanism is available in the Netherlands outside of formal insolvency proceedings (suspension of payment proceedings and bankruptcy), which have proven at times to be difficult tools for reorganisation. Currently, an out of Court restructuring plan can only be approved if all creditors consent. The lack of an effective restructuring tool can allow creditors to block a necessary restructuring (perhaps unreasonably at times). In doing so, the creditor can exert leverage and manoeuvre itself into a position more favourable than it would occupy in the event of a liquidation of the debtor’s assets. The WHOA seeks to prevent just that, facilitating the confirmation of a restructuring plan and ensuring that it is binding on dissenting creditors.

The Netherlands is the first Member State in the EU proposing new legislation for the implementation of the “Restructuring Directive” (Directive 2019/1023 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt). The procedure(s) provided through the WHOA are meant to be swift, flexible and efficient, and in a large part is based on elements of both the US chapter 11 and the UK scheme of arrangement.

The Dutch implementation of the Restructuring Directive

In our Fall 2019 *International Restructuring Newswire*, Matthew Thorn and Manhal Zaman provided a report and description of the key aspects of the Restructuring Directive (as well as similar reforms in the United Kingdom). As was noted there, the Restructuring Directive is dependent on EU Member State implementation through legislation and thus provides a platform for competition among Member States for establishing user-friendly restructuring procedures. In this article, the focus will specifically be on the implementation of the Restructuring Directive in the Netherlands, so far as the introduction of a preventive restructuring framework is concerned.

The proposal for the WHOA was submitted to the Dutch House of Representatives ten days after the European Parliament and the Council published the text of the Restructuring Directive. By doing so, the Netherlands has taken the first shot at implementation and at seeking to become a leading restructuring hub globally. The timing could not have been better, as the economic indicators seem to point towards the next downturn in the next six to twelve months.

Some key characteristics

The procedure provided in the WHOA has a number of key characteristics, for example:

- it is a debtor-in-possession procedure;
- the procedure is conducted outside of formal bankruptcy proceedings;
- there is limited Court involvement; there is no Court-assessment at the very start of the procedure;
- cram-down and cross class cram-down are possible; and
- intended to being used for all sizes of enterprises, including small and medium sized enterprises (SMEs), to which a number of specific additional provisions apply.

Who can take the initiative to prepare and propose a plan?

A debtor can propose a plan to its creditors and shareholders if it can reasonably be assumed that the debtor will not be able to continue paying its debts as they fall due. The debtor however does not enjoy total exclusivity in the plan process. Each creditor, shareholder or statutory works council or workplace representative set up in the debtor's business (these are bodies that represent the companies workers) may request that the Court appoint a 'restructuring expert', who has the right to propose a plan for the debtor.

Under the WHOA, SMEs will have to approve the proposal of a plan by a 'restructuring expert'; as well as submitting the adopted plan to the Court for confirmation in case the plan will possibly be forced upon a dissenting class of creditors.

A dual-track approach – public and confidential procedures

The WHOA provides for a dual-track approach, meaning that at the very start of preparing the plan, the debtor or 'restructuring expert' will choose to follow either the public procedure or the confidential procedure as set out in the WHOA.

In a public procedure, the preparation of a plan is published in the Dutch central insolvency register, the Dutch Government Gazette and the Dutch trade register and any Court hearings will be public. Conversely, the preparation of a plan in a confidential procedure is not announced and any Court hearings will be held in chambers. The public procedure will be submitted to be included in Annex A of the EU regulation 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the "Insolvency Regulation (recast)"). On the other hand, the confidential procedure will not fall within the scope of the Insolvency Regulation (recast).

As a consequence, confirmed restructuring plans following a public procedure are likely to be more easily recognised and enforced in the Member States of the EU, whilst Dutch Courts may more readily assume jurisdiction to decide on, *inter alia*, the confirmation of restructuring plans prepared in the course of a confidential procedure. Which path to choose will depend on the specifics of the matter and the location of the debtor's creditors. Interestingly, by making use of the confidential procedure, non-Dutch debtors may seek to have their restructuring plan confirmed by the Dutch Courts in accordance with the WHOA – provided they have a sufficiently close connection to the Netherlands (the threshold for which is relatively low).

Two new players in the field

The WHOA introduces two new players in the field of Dutch insolvency proceedings, the aforementioned 'restructuring expert' and the 'observer'.

The role of a 'restructuring expert' is limited to the preparation of a restructuring plan. The 'restructuring expert' is not involved in the day-to-day business of the debtor, as the debtor remains in possession while a restructuring plan is being prepared and proposed by the 'restructuring expert'. Upon the appointment of a 'restructuring expert' by the Court, the debtor can no longer propose a plan to its creditors and shareholders, but the debtor can request the 'restructuring expert' to propose the debtor's plan to its creditors and shareholders and put that plan to a vote.

An 'observer' comes into play in the event of a proposed cross class cram-down under a plan or where the Court orders a general stay. The task of the 'observer' is to monitor the process relating to the preparation of the plan, taking into account the interests of the creditors of the debtor.

The WHOA does not detail the competences or qualifications required for appointment as a 'restructuring expert' or 'observer'. In the Dutch restructuring market, various opinions exist as to the suitability of individuals for appointment to these roles. Some practitioners are of the view that bankruptcy trustees will be best-suited for appointment as a 'restructuring expert', whilst others consider the CRO-type of professionals to be most appropriate. Potentially, offering services as restructuring experts will become a new niche in professional circles in the Netherlands. Time will tell, and the circumstances affecting particular companies – and the specifics of restructuring plans required – might mean the suitability of particular candidates will vary on a case-by-case basis.

The process: from financial difficulties to a confirmed plan





The process starts with the preparation of a restructuring plan by either the debtor or the 'restructuring expert'. The debtor or 'restructuring expert', as the case may be, enjoys great flexibility in formulating the arrangements to be included in the restructuring plan. The WHOA prescribes that the restructuring plan needs to contain certain information in order for the creditors to be able to make an educated decision on voting in favour or, or against, its adoption. Apart from prohibiting impairment or amendment of rights arising from employment contracts, the WHOA does not set limitations on the arrangements that can be included in the restructuring plan. For example, the restructuring plan can provide for a reduction and/or restructuring of the debt, a debt-for-equity swap, or the issuance of new shares. Furthermore, the restructuring plan may provide for the restructuring of obligations of affiliated group entities of the debtor, effectively allowing for group restructurings. Also, the restructuring plan may entail the amendment and – if such amendment cannot be agreed upon – the termination of burdensome contracts akin to the rejection power found in US chapter 11 procedures. In addition, the rights of secured creditors may, in certain circumstances, be amended by the restructuring plan.

In the restructuring plan, the creditors and shareholders must be divided into classes. The WHOA provides that creditors whose rights are so different that they are not considered to be in a similar position, should be placed in different classes. Such comparison of positions is to be made against the backdrop of both: (i) the creditors' position in the event of the liquidation of the debtor; and (ii) their rights as varied by the restructuring plan (if confirmed). As a rule of thumb, shareholders should be placed in a separate class, as must be holders of a right of pledge and other secured creditors (for example).

When finalised, the restructuring plan will be proposed to those (classes of) creditors and shareholders whose rights are sought to be amended. Only affected creditors will be allowed to vote. The debtor or 'restructuring expert' can decide to submit the plan only to one or a few classes of creditors. The rights of other creditors cannot be amended by means of the restructuring plan.

A class is deemed to have voted in favour of the restructuring plan if creditors together representing two-thirds of the total amount of the claims of creditors in that class voting in favour. There is no headcount or numerosity requirement that needs to be satisfied. If at least one class of creditors has voted in favour of the restructuring plan, the plan can be submitted to the Court for confirmation. If no 'restructuring expert' or 'observer' is appointed and no interim decisions are requested by the debtor, the confirmation hearing will be the first time the Court becomes involved in the process. Up until that moment, the procedure will be conducted outside of any Court-supervision.

If the restructuring plan is submitted to the Court, the Court will decide whether or not to confirm the plan. In that context, the Court is required to consider the so-called 'general grounds for refusal' at its own initiative.

General grounds for refusal include:

- it is not reasonably likely that the debtor will be unable to continue paying its debts as they fall due, in absence of a restructuring plan;
- the plan does not contain the prescribed information;
- the class formation does not meet the statutory requirements;

- the performance of the plan is not adequately assured; and
- the plan is deceptive.

Furthermore, the Court will – at the request of a dissenting creditor that is (or should have been) placed in a class that has voted against the restructuring plan – consider the so-called ‘additional grounds for refusal’.

Additional grounds for refusal include:

- a failure to comply with the ‘best interests of creditors’ test, which means that creditors should not be worse off under the plan than in case of bankruptcy of the debtor;
- an unjustified breach of the absolute priority rule, which requires that lower ranking creditors cannot receive value unless higher ranking creditors are fully paid; and
- creditors that voted against the restructuring plan and are in a class that is to be crammed-down are not given the opportunity to opt for a “cash-out” equal to the value such creditor would have had received in the case of a bankruptcy (liquidation) of the debtor.

Upon confirmation by the Court, the restructuring plan is binding on the debtor and all creditors that were entitled to vote on the plan.

From start to finish, the process from the proposal of a restructuring plan until the Court confirmation should be capable of being finalised within four to five weeks, as the procedural timeframes provided for in the WHOA are relatively short.

Supportive measures

At the request of the debtor or ‘restructuring expert’, the Court may order a variety of supportive measures. These measures are intended to facilitate the smooth preparation of the restructuring plan and the continuation of the business of the debtor during the interim period.

These supportive measures include:

- a general or tailored stay, applying to all creditors or only to certain creditors, for an initial period of four months, with the possibility of a four-month extension;
- the suspension of a pending bankruptcy (liquidation) application in respect of the debtor;

- the lifting of attachments;
- protecting security granted for emergency funding against claw-back risks;
- setting aside *ipso facto* and change of control clauses in contracts;
- allowing the debtor to use encumbered assets in the ordinary course of its business in exchange for proper security, similar to adequate protection in US chapter 11 procedures; and
- bespoke provisions, such as declaring a pre-emptive right inapplicable in the circumstance where new shares are to be issued in the plan.

Furthermore, before the plan has been proposed to the creditors for voting purposes, the Court can be asked to give rulings on certain issues that are relevant in respect of the confirmation. Such rulings can be requested by the debtor or the ‘restructuring expert’. A ruling can include a binding decision on issues such as the scope and adequacy of the disclosure information required to be provided in the plan, class formation, the admission of a creditor to a certain class, or whether any of the grounds for refusal (general or additional) exist. It is hoped that allowing the debtor and restructuring expert to ask for such a binding ruling early in the process will mean that obstacles to seeking confirmation of a plan can be avoided down the line.

Expectation

If the WHOA is enacted as currently drafted and within the expected timeframe, the Netherlands will be at the forefront of implementing the Restructuring Directive. The WHOA may very well serve as a blueprint for those Member States of the EU that do not currently have detailed restructuring legislation (or proposals) in place.

Restructuring lawyers and accountants in the Netherlands anticipate that the WHOA will be enacted in a form which closely follows the current proposal; only few changes to the proposal are expected at this stage (if at all). The legislative process is expected to be finalised in 2020 (it is currently with the Dutch House of Representatives and will still need to go through the Dutch Senate before it enters into force). Stay tuned for further developments.

Koen Durlinger is an associate in our Amsterdam office in the firm’s dispute resolution and litigation group.

The CCAA proceedings of Stornoway Diamond Corporation and its innovative approach to vesting orders

Arad Mojtahedi

Takeaway

The CCAA proceedings of Stornoway demonstrate an innovative use of the CCAA sale process as an alternative to plans of arrangement where there is no value remaining beyond the realization of secured debt and the parties intend to maintain the going concern operations of the debtor company. The Stornoway case provides further judicial recognition of the notion that when there is no value beyond the senior creditors' debt, the CCAA's purpose and objective may be achieved by facilitating the enforcement of secured rights and the effective discharge of certain junior debts, so long as the transaction is aimed at preserving a business's going concern operations.

The factual context

On September 8, 2019, as a result of its insolvency, Stornoway Diamond Corporation and a certain number of its subsidiaries ("Stornoway") filed an initial motion seeking creditor-protection pursuant to Canada's *Companies Creditors' Arrangement Act* (the "CCAA").

Stornoway is a Canadian mining corporation, which was listed on the TSX prior to the CCAA proceedings and employs 540 employees. Its main operation is centered around the Renard Mine (one of only four diamond mines in Canada and a flagship component of Québec's *Plan Nord*).

Construction at the Renard Mine commenced on July 10, 2014, following the successful completion of a comprehensive CAD\$946 million financing package designed to fully fund the project to completion. The Renard Mine financing was the largest single project financing transaction for a publicly listed diamond company in Canada, and included equity, senior and convertible debt, equipment financing and the world's first ever diamond stream financing, in which a streaming company makes an upfront payment to a diamond company in return for the right to purchase a fixed percentage of future production of diamonds produced by a project, and makes on-going payments for each unit delivered under the streaming agreement.

An unfortunate storm of challenges hit the mine at the outset. During the first two years of operation, diamond production fell short of projections due to delayed underground mine ramp-up (attributable to unexpected rock conditions) coupled with lower-grade ore in the initial extractions

and higher than anticipated levels of diamond breakage. On top of the operational problems, the second half of 2018 also saw a rough diamond market price correction. This market decline was partly attributed to happenings in India, where rough diamonds are made into finished products. The Indian diamond industry suffered due to the weakening Indian Rupee, the lack of available credit available to Indian diamantaires, excess of polished inventory in India and lower margins in manufacturing. At the time of its financing, the projected average price for the Renard Mine diamonds was set at US\$147/ct. The average pricing achieved in the second quarter of 2019 was only US\$76/ct, with a continued downward trend.

In light of its financial difficulties, in June of 2019, Stornoway, with the assistance of its financial advisors and with the support of and financing from its principal secured lenders (the "Secured Creditors"), initiated and conducted a sale and investment solicitation process.

On July 15, 2019, a single third-party bidder submitted an offer for the acquisition of Stornoway's assets, which bid was for an aggregate consideration significantly less than the aggregate secured indebtedness owing to the Secured Creditors. After careful review, Stornoway and the Secured Creditors came to the conclusion that the bid was not satisfactory in the circumstances.

Since the sale procedures clearly and expressly foresaw the right of the Secured Creditors to submit a credit bid up to the amount of their secured indebtedness, the parties began negotiating the potential terms and conditions upon which a credit bid could be implemented from

a transactional standpoint. On September 8, 2019, these discussions ultimately led to the execution of a letter of intent between Stornoway and the Secured Creditors (the "LOI").

The CCAA proceedings

On September 9, 2019, the Superior Court of Quebec (Commercial Division) (the "Court") granted the Initial motion in the CCAA proceedings, which was sought in order to implement the LOI. At that point, Stornoway's accumulated deficit amounted to approximately CAD\$660 million. As at August 31, 2019, the estimated outstanding liabilities of Stornoway, excluding contingent liabilities, amounted, on a consolidated basis, to approximately CAD\$715 million.

As part of the Initial Order, the Court also granted various other relief in favour of Stornoway, including the authorization for Stornoway and its subsidiaries to enter into a working capital facility with its Secured Creditors, giving them access to an additional CAD\$20 million in liquidity, which could be increased to up to CAD\$50 million, in order to provide a runway to complete the sale in the CCAA proceedings.

On October 4, 2019, a Share Purchase Agreement (hereinafter referred to as the "SPA") was entered into, whereby the Secured Creditors agreed to acquire by credit-bid, through a newly formed entity, substantially all of the business of Stornoway. The SPA was approved by the Court on October 7, 2019 through the issuance of an Approval and Vesting Order. The SPA preserved and assumed, *inter alia*, all obligations of Stornoway towards its trade suppliers (including pre-filing obligations) and the near totality of its employees.

The innovative approach to the vesting order

There were significant liabilities, however, that were not assumed by the Secured Creditors in connection with the credit-bid transaction. These non-assumed liabilities were transferred, assigned and vested in newly incorporated non-operating companies as part of a pre-closing reorganization. The Monitor's powers were then expanded so as to enable it to assign the new companies into bankruptcy under the *Bankruptcy and Insolvency Act*.

This type of transaction would have typically taken the form of a secured creditor plan of arrangement where the plan offered nothing to unsecured creditors. The plan route would involve additional Court process and a longer timeline to achieve the goal. Instead, it was decided to take a sale path through the use of what can more appropriately be called a "Reverse Vesting Order" in which the non-assumed liabilities (and certain other assets) were extracted from the business by virtue of the Court's order.

By vesting out its unwanted assets/liabilities, the business of Stornoway emerged from CCAA proceedings swiftly while preserving its going concern operations and the tax attributes in relation thereto. Additionally, the vesting order allowed for an effective change of control. Another one of the particularities was that the vesting order granted broad releases in favour of third parties, notably the directors and officers of Stornoway and the purchaser who played a key role in the reorganization.

Such transactions are permitted under the CCAA, which is remedial legislation designed to enable insolvent companies to restructure, particularly where such transactions are to permit an internal reorganization that is fair to the interests of affected stakeholders and there is no prejudice to the Applicants' major creditors. The Court relied on precedents which had recognized that the transfer of liabilities out of the insolvent debtor may be effected when it (a) facilitates the restructuring of the debtor company into a competitive industry participant, (b) preserves the going concern value for stakeholders, (c) preserves the employment of many employees, (d) was extensively negotiated amongst stakeholders with significant interests, and (e) did not prejudice the major creditors of the debtor company.

The transaction approved by the Court for Stornoway demonstrates the flexibility that CCAA proceedings offer for distressed M&A transactions and secured creditor realization. The structure enabled a quick disposition to the secured parties and the continuation of the business as a going concern outside of the usual lengthy plan of arrangement process. Secured lenders to Canadian companies should take note of this case, which provides lenders with a tool for an efficient acquisition of a distressed business, while maintaining tax attributes and isolating unwanted liabilities.

Arad Mojtahedi is an associate in our Montreal office in the firm's dispute resolution and litigation group.



The chill of competition constraints on the sale of distressed businesses in Australia

Tim Mornane and Jonathon Turner

A recent decision by the Australian Competition and Consumer Commission (“ACCC”) to oppose a proposed sale by voluntary administrators of a group of companies producing chilled ready / takeaway meals is a reminder to insolvency practitioners (e.g., administrators and receivers) as well as creditors and other stakeholders of the limitations imposed by the Australian competition regime in connection with the sale of shares and/or assets of a distressed entity. Indeed, the restraints and hurdles imposed by the competition regime sit awkwardly with an insolvency practitioner’s duties and obligations under Australia’s insolvency regime. This potential to dampen insolvency sales is not limited to Australian insolvency proceedings since similar antitrust positions are reflected in many jurisdictions around the world.

While the ‘failing firm’ doctrine is recognised in Australia and a number of international jurisdictions, whether as part of the counterfactual analysis, a defence or an exception to the prohibition on transactions that substantially lessen competition, the stringent requirements imposed by the ACCC have the effect of rendering this doctrine illusory in all but the rarest of cases. Indeed, the evidentiary burden that is required to be satisfied ensures that it only becomes available when enterprise value has materially deteriorated.

TV dinners under threat

Jewel Fine Foods Pty Ltd (In Administration) (“Jewel”) is a manufacturer of chilled pre-cooked ready meals that require little preparation by consumers and are sold across Australia through supermarkets, petrol stations, convenience stores and other outlets. Jewel had been placed into voluntary administration in April 2019 due to financial difficulties.

The preferred bidder identified through the voluntary administrators’ sale process, Beak & Johnson City Kitchen Pty Ltd (“B&J City”), is a food processing business that sells fresh cut and value added meat products, fresh soups, sauces and prepared meals.

Following an informal review process that commenced in late July 2019, the ACCC announced in September 2019 its opposition to the proposed acquisition of the business of Jewel by B&J City. Following the ACCC’s determination, the voluntary administrators remarketed the business for sale, with their sale process ongoing.

Why competition regimes are important to insolvency practitioners

While insolvency proceedings foster sales that allow businesses to continue as going-concerns and generate the highest and best return for creditors, the antitrust and competition laws nonetheless continue to apply and may put pressure in the opposite direction.

The *Competition and Consumer Act 2010* (Cth) (“Competition Act”) governs competition matters in Australia and provides that the objective of the regime is to “*enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection*”.

Section 50 of the Competition Act provides that a person must not acquire the shares or assets of another if that acquisition would have the effect, or likely effect, of substantially lessening competition in any market for goods and services in Australia. The ACCC considers the effects of the transaction by comparing the likely future state of competition if the transaction proceeds to the likely future state of competition if the transaction does not proceed. This is more commonly known as the ‘with or without test’. This substantially lessening competition formulation is mirrored in other jurisdictions including the United States, the United Kingdom, the European Union, Hong Kong and Singapore.

Notwithstanding that competition clearance in Australia is not mandatory, there is a material risk that, if clearance is not sought and the ACCC considers that the transaction will substantially lessen competition, the ACCC will seek to block the transaction from proceeding or seek to unwind it post-closing. Further, substantial penalties and fines may be imposed

on the corporation and its officers. This potential liability could, in certain circumstances, apply to the insolvency practitioner managing the sale of the business and/or assets where it is operating in the capacity of an officer of the corporation.

Accordingly, the purchase of assets from a company that has been placed into voluntary administration, liquidation or receivership may require ACCC clearance. Either authorisation or an informal process can be utilised. Unlike other jurisdictions, the Australian regime does not contain mandatory reporting of proposed acquisitions if the relevant threshold is met and as such it is a matter of discretion. However, the ACCC may unilaterally commence its own review of a proposed acquisition where it is not notified.

The authorisation process, if successful, provides the applicant with finality and statutory protection from legal action arising from breach of the Competition Act pursuant to any share or business acquisition. This is a statutory 90 day process (which may be extended by agreement with the ACCC). This gives a greater level of certainty over the timeframe for a decision and is a transparent public process.

The informal clearance process does not provide statutory protection, but it does provide comfort to the parties that the ACCC will not take action to seek the transaction from completing. The length of the process is driven by the level of enquiries that the ACCC is required to make in order to vet the transaction. For acquisitions where the ACCC needs to make enquiries of, and seek submissions from, competitors and other market participants, the review process can take three to six months (or longer in particularly complex cases). Accordingly, requiring competition clearance may prevent an insolvency practitioner from achieving a quick sale of a company's assets.

Both the informal and authorisation processes necessarily involve a delay in concluding the proposed transaction. Further, any review of the ACCC's determination requires either proceedings in the Federal Court, or in the case of authorisation review by the Tribunal which will make its own findings of fact and reach its own conclusions, or by judicial review of the decision by the Federal Court on a question of law, that will similarly involve further delay. This is contrary to the truncated timetable provided by the voluntary administration regime and hampers an insolvency practitioner's attempts to both preserve a going-concern business and realise value for creditors through a sale.

Failing firm principle to the rescue?

The ACCC recognises the 'failing firm' doctrine in its consideration of whether a transaction will substantially lessen competition. Unfortunately, in Australia this doctrine provides extremely limited comfort given the stringent criteria that is applied and effectively ensures that it is only available in the rarest of occasions and in circumstances where attempts to restructure and preserve enterprise value have failed.

The 'failing firm' doctrine is not a statutory defence but rather only a factor to be taken into consideration when conducting the 'with or without test'. It is necessary to show that: (i) the relevant target firm is in imminent danger of failure and is unlikely to be successfully restructured without the merger; (ii) in the absence of the merger, the assets associated with the target firm will leave the industry; and (iii) the likely state of competition with the merger would not be substantially less than the likely state of competition after the target has exited and the target's customers have moved their business to alternative sources of supply.

The current position of the 'failing firm' doctrine in the Australian market is highlighted by the fact that it is not referenced in the Merger Guidelines (notwithstanding that it had appeared in earlier versions). It is applicable in only extremely limited circumstances and the evidentiary burden to satisfy the threshold is incredibly high. Indeed, the ACCC would need to conclude (mere speculation is insufficient) that the insolvent target's business would exit the market absent the transaction and that the target's assets would not otherwise be used productively by competitors other than the acquirer. The high evidentiary threshold to be satisfied, coupled with the delay and cost of obtaining clearance, may result in unnecessary value destruction to all stakeholders — e.g., secured creditors, unsecured creditors, vendors, and employees.

Not all TV dinners are equal

The ACCC opposed the proposed sale of the Jewel business to B&J City on the basis that it would substantially lessen competition in respect of the supply of chilled ready meals with the potential for consumers to face increased prices.

Importantly, the ACCC held that chilled ready meals ought to be separated from other convenience meals such as frozen ready meals and other prepared takeaway food (e.g. pizzas, soups and quiches). While the ACCC acknowledged there are a large number of competitors in ready meals, it determined that Jewel and B&J City operate in a niche market and the transaction would combine the two major players, thereby concentrating manufacturing capacity in one business. The ACCC also determined that *"if the proposed acquisition does not proceed, an alternative purchaser is likely to buy Jewel and compete strongly with B&J City Kitchen"*.

The position adopted by the ACCC in this case is consistent with the approach they have taken historically. There are, however, a limited number of cases where the ACCC has determined not to oppose an acquisition notwithstanding that it was likely to substantially lessen competition on the basis of the 'failing firm' doctrine.

In 2015, the ACCC determined not to oppose a transaction between VIP Steel Packaging Pty Ltd ("VIP") and National Can Industries Pty Ltd ("NCI"), both of which supplied plastic and steel packaging products, stating that *"in this case there was clear evidence that the relevant assets*



would leave the market if VIP Steel's proposed acquisition does not go ahead. In these circumstances, the opportunities for competition in the supply of new steel drums would be the same with or without the proposed acquisition". In so doing, the ACCC appointed their own forensic accountant to examine the financial documentation and confirm the company's imminent demise.

Similarly, in February 2009, the ACCC confirmed they would not oppose the proposed acquisition of Hans Continental Smallgoods by P&M Quality Smallgoods. The ACCC concluded: "*unless acquired by Primo, Hans would be likely to cease trading imminently and would be liquidated by the administrator*". Hans had been placed into voluntary administration in late 2008 and no alternative bids had been received for the business or the company's assets that "*were capable of being finalised prior to the administrator being required to take steps to close the business*". The ACCC went on to note that "*the ACCC will assess any failing firm argument rigorously and will require clear information to show both that the target is likely to fail without the acquisition, and that this is not a better outcome for competition than an acquisition by a competitor*".

What is good for competition may not be so good for stakeholders

The narrow operation of the 'failing firm' doctrine advanced by the ACCC, which mirrors the stance taken by equivalent regulators in certain other jurisdictions, sits awkwardly with the duties and obligations imposed on insolvency practitioners pursuant to the *Corporations Act 2001* (Cth) ("*Corporations Act*") and may inhibit attempts to restructure and preserve enterprise value.

The voluntary administration regime is intended to provide for the business of an insolvent company to be administered for the purposes of maximising the chances of the company, or as much as possible of the business, continuing in existence and thus provide what is usually expected to be a better return for creditors than would have been achieved in an immediate liquidation. Accordingly, voluntary administrators are obliged to maximise the chances of the company, or as much as possible of its business, continuing in existence. In the absence of some other form of capital restructure, a sale of the business on a going-concern basis is often the best avenue to ensure that the business continues for the benefit of all stakeholders, including secured and unsecured creditors and employees.

Further, the voluntary administration regime is intended to be conducted on a truncated timetable so that the future of the company can be determined expeditiously before the loss of enterprise value that may occur as a result of both lengthy and uncertain restructuring proceedings and a liquidation scenario. While extensions can be granted by the Court, and not infrequently are, the potential for delay while the ACCC investigates a proposed acquisition risks the dissipation of value during this holding period. It is this potential for loss of enterprise value that the voluntary administration regime is intended to avoid.

In the *Jewel* decision, the critical factor relied on by the ACCC to oppose the sale was the fact that other alternative purchasers, albeit at a lower price, had been identified in the sale process. The ACCC proceeded on the assumption that these other parties remained viable alternative purchasers in a further sale process notwithstanding the passage of time while the review was undertaken. In such a scenario, however, there is a real possibility that the previously identified purchasers may not be willing to participate in a further sale process. Further, assuming buyers

are still interested, it is possible that the renewed sale process will result in a loss of value and/or discount. Stakeholders, including employees and creditors, may be significantly worse off in such a scenario. For example, any number of sale terms may be negotiated downward (including pricing at significantly lower levels), retention of jobs for the insolvent target's employees may be downgraded, and, of course, an alternative acquisition may not close at all, thereby causing the company to fall into liquidation. This is to be contrasted with the material efficiency gains and social benefits to be achieved by proceeding with the original acquisition. For example, continuity of employment and the redeployment of capital in the economy.

In the context of a receivership, section 420A of the Corporations Act provides that receivers are obliged to either sell the assets at not less than market value or the best price that is reasonably obtainable. It is readily apparent that this obligation is contradicted by the obligations under the Competition Act. Accordingly, receivers are required to balance two potentially competing statutory obligations under the threat of personal liability for breach of either.

Further, receivers, liquidators and voluntary administrators, as officers of a company, will be required to act in the best interests of the company, which in an insolvency context will focus on the interests of creditors but will also include employees of the entity. This duty is also supportive of an obligation to obtain the best possible price for the sale and the continuation of the business as a going-concern.

Key takeaways – pun intended

While it is hoped that the divergences between the two regimes will be examined by the legislature in the future, reform in this area is unlikely in the short term and the Jewel decision indicates that insolvency practitioners should consider the likely competitive implication of a sale early in the process to ensure that any competition clearance process does not inhibit a timely completion. When conducting a sale process a practitioner is obliged to act in the best interests of the company, in particular its creditors in an insolvency context. The competition regime has the potential to temper this where it is not given appropriate weight in determining the most appropriate purchaser, potentially adversely impacting creditors, employees and/or the chances of the business continuing in existence.

Key takeaways are:

- Notwithstanding the voluntary nature of the reporting regime under the Competition Act, it is critical to engage with the ACCC and obtain specialist competition law advice at the earliest opportunity.
- Insolvency practitioners (as well as creditors and other stakeholders) must be aware of the potential competition obstacles that may need to be overcome or at least mitigated when selling a distressed company's assets or shares.
- When assessing the impact of the proposed acquisition, the ACCC may define the market narrowly. The risk of intervention of the ACCC will be heightened when selling to a potential competitor in a niche market as compared to competitors in broader markets.
- Obtaining ACCC clearance for an acquisition has the potential to be a time consuming process which may have a significant impact on the potential transaction. This ought to be taken into consideration in respect of any sale process and the determination of a preferred bidder.
- Finally, insolvency practitioners may face personal liability for a breach of the Competition Act where they are an officer of the company, and thus should pay special attention to these matters and the key takeaways.

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UBS v Fairfield Sentry: UK Privy Council says that US courts can use British Virgin Islands' insolvency law

Radford Goodman and Aditya Badami

Key Points

In *UBS AG New York and others v Fairfield Sentry Ltd (In Liquidation) and others* (“Fairfield”), the Judicial Committee of the Privy Council in London (“Privy Council”), sitting as the highest UK appellate court for certain British Overseas Territories, held that section 249 of the British Virgin Islands Insolvency Act 2003 (the “Act”), which concerns setting aside preferential transactions, may be applied by a non-BVI court since the Act “*does not prohibit a foreign court from exercising the powers which it confers.*” The Privy Council held that whether such a foreign court could, in fact, exercise the powers under section 249 was a matter for that foreign court to decide.

The Privy Council, therefore, rejected an application for an anti-suit injunction that sought to halt the liquidators of a BVI-based investment fund from asserting preference claims in a United States Bankruptcy Court under section 249 of the Act to recover funds paid out to investors.

The Privy Council's decision and reasoning could have implications beyond the BVI, including in relation to UK insolvency cases and certain other offshore jurisdictions that continue to use the Privy Council as the court of final appeal.

Background

The “claw back” actions by the trustee of the Madoff fund and its various feeder funds continue to reverberate through the courts. *Fairfield* involved a trio of BVI-based investment funds—Fairfield Sentry Ltd (“Sentry”), Fairfield Sigma Ltd, and Fairfield Lambda Ltd—that were “feeders” to the Madoff fund, to the tune of approximately US\$7 billion. When the Ponzi scheme was revealed for what it was, the BVI feeder funds were left exposed to billions of dollars of losses and, following Mr Madoff's arrest in 2008, the BVI High Court made orders to wind-up each of them.

Before being wound-up, the feeder funds had issued redeemable shares to investors, the redemption value of which was allegedly based upon fraudulent valuation reports prepared by the Madoff fund. The Sentry liquidators asserted that UBS AG New York (“UBS”) and other investors redeemed their shares “*at valuations which, as hindsight reveals, bore no relationship to the actual value of their shares.*” The liquidators commenced

litigation to claw back the funds paid out to hundreds of investors in Sentry, including UBS, on common law grounds and under the preference provisions of section 249 of the Act. Despite relying upon the BVI insolvency statute, the litigation was not commenced by the liquidators in the BVI courts, but rather in the US Bankruptcy Court for the Southern District of New York in the *Fairfield* Chapter 15 ancillary proceeding.

UBS went back to the BVI and sought an anti-suit injunction from the BVI courts to prevent the liquidators from proceeding with their claims in the US. The application was dismissed at first instance by the BVI High Court, which was upheld by the Court of Appeal of the Eastern Caribbean Supreme Court and, ultimately, made its way to the Privy Council in London.

The arguments

Before the Privy Council, UBS argued that section 249 “*conferred a right to grant relief only on the [BVI] High Court which was a domestic court charged with the supervision of the winding up*” and that, as a result, “*no foreign court was empowered to grant such relief.*” UBS also maintained that the BVI court had no authority to delegate its powers under section 249 to any foreign court and had not purported to do so.

The liquidators submitted that, in essence, section 249 did not restrict its use by a foreign court and that “*it was for the US Bankruptcy Court to decide under US rules of private international law whether it would apply BVI insolvency law in dealing with the liquidators' applications.*”

The liquidators also noted that UBS had made the same or similar arguments to the US Bankruptcy Court, which had declined to dismiss the claims asserted by the liquidators under section 249 of the Act.

Privy Council decision

The Privy Council found in favour of the liquidators and in the critical passage of the panel's reasoning, the panel held that section 249 "contains no express prohibition on a foreign court from exercising those powers [under Section 249] at the request of a BVI office holder and no such prohibition arises by necessary implication." The panel continued: "In short, the section does not address the matter of the powers of a foreign court; one would not expect it to do so. On the contrary, it is a question for each foreign court from which a BVI office holder seeks assistance to determine whether it can use the statutory tools which BVI insolvency legislation has conferred on the BVI court."

In reaching this conclusion the Privy Council identified in the Act an overarching concern to assist foreign insolvency proceedings. This concern militated against any implication that claims under section 249 could only be asserted by liquidators in a BVI court. The Privy Council was also mindful of the regularity with which courts in one country apply the insolvency laws of another when giving assistance to the latter country. With that in mind, the Privy Council considered it to be all the more appropriate to interpret section 249 so as to permit a foreign court to exercise the claw back powers which section 249 conferred.

Balancing act

As noted at the outset, the Privy Council distinguished the liquidators' ability to commence proceedings in the US from the US courts' decision whether to apply BVI law as the liquidators requested. This distinction reflects a careful balance struck between three objectives: first, encouraging cooperation between jurisdictions in international insolvencies; second, empowering liquidators in one country to take steps in another country as necessary to fulfil their mandate; and, third, respecting the autonomy and competence of other countries' courts to decide issues of law for themselves.

Fairfield confirms the willingness of US, BVI, and UK courts to assist insolvency office holders appointed by foreign courts and, if necessary, to apply the insolvency law of that foreign jurisdiction. Although there may be differences in the various insolvency statutes, the policy and reasoning behind the Privy Council's decision has relevance to foreign courts' abilities to use the claw back tools contained in the insolvency laws of the UK, certain British Overseas Territories (e.g. BVI, Bermuda, and Cayman Islands), and those Commonwealth countries (e.g. The Bahamas) that still designate the Privy Council in London as their highest appellate court.

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In midst of credit crisis, India implements further changes to bankruptcy laws

Bandar Al-Saif

In May 2016, India enacted the Insolvency and Bankruptcy Code (“IBC”), which completely overhauled the bankruptcy laws in India. The IBC aimed at synthesizing and improving India’s restructuring laws in order to provide restructuring outcomes with greater certainty and efficiency thereby incentivizing further investment into the country. Prior to the IBC, India’s insolvency resolution process involved a range of legislation that had been passed over several decades. The applicable insolvency laws included the Sick Industrial Companies Act (1985), the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (2002), the Recovery of Debt Due to Banks and Financial Institutions Act (1993), and the Companies Act (2013). This collection of laws created a fragmented and, at times, contradictory bankruptcy regime in India. As a result, decisions were often appealed, stayed, or overturned, resulting in long delays in insolvency cases, with the average resolution taking four and a half years.

The IBC sought to remedy the situation by consolidating the insolvency laws under one statutory scheme. Insolvencies pertaining to stock corporations, partnerships, limited liability companies, and individuals all fall within the bounds of the IBC. Much like the US bankruptcy model, insolvency proceedings for a debtor under the IBC begin with a resolution process that is geared towards reaching a plan of reorganization. If the resolution process fails, the debtor then is subject to liquidation proceedings to settle the outstanding claims.

Despite the broad reach of the IBC to commercial enterprises, one notable debtor type remained excluded: non-bank financial firms. With many so-called large “shadow banks” in a state of financial turmoil in recent years, the Indian government took the initiative in 2019 to expand the IBC to apply to these financial businesses and to otherwise amend the IBC to bolster the rehabilitative process.

Trouble for shadow banks

The shadow banking system in India is comprised of non-bank financial intermediaries that provide services similar to traditional commercial banks. Shadow banks, however, are not subject to the same regulations as traditional banks and often lend to higher risk borrowers. Shadow banks, therefore, are particularly susceptible to downturns in the economy.

Following aggressive lending over the past few years, the first sign of crisis for shadow banks appeared when Infrastructure Leasing & Financial Services Limited (“IL&FS”), India’s leading infrastructure non-bank finance

company, defaulted in September 2018. The country’s Central Government responded by asking the National Company Law Tribunal (“NCLT”) to remove and replace IL&FS’s Board of Directors. On October 1, 2018, the NCLT suspended the existing board and appointed six new board members. Although IL&FS became insolvent more than a year ago, it has yet to enter a formal bankruptcy process. Instead, the government has been working to sell off the company’s assets in parts.

Even with the damage control efforts implemented by India’s government, the consequences of IL&FS’s collapse have rippled through the Indian economy, causing distress in the construction industry. By the end of September 2018, over 200 infrastructure developers in India had initiated proceedings in bankruptcy court. Since then, that number has more than doubled. The rise in developer insolvencies has been largely attributed to their inability to receive adequate funding due to the pull back in lending by commercial banks and distress in the shadow bank sector. In that regard, credit disbursements by shadow banks dropped by nearly one third in 2019, following aggressive growth in the past three years.

With commercial banks in India already struggling with heightened levels of non-performing assets, there has been no indication that the lending void left by shadow banks will be filled anytime soon. The consequences of IL&FS’s insolvency have been so severe that many have referred to it as India’s “Lehman moment.” While others have been quick to argue that the impact of IL&FS has been far less systemic than Lehman, with no major bank failures or the onset of a recession, troubles at other major shadow banks are likely to accelerate the lending slowdown that has continued since late 2018.

In hopes of facilitating better outcomes for distressed shadow banks, and thereby bolstering liquidity for developers and other enterprises, India amended its bankruptcy and insolvency rules to bring these non-banking finance companies – shadow banks – within the scope of the IBC and amended the IBC generally to foster restructuring efforts.

Recent adjustments to India's bankruptcy laws

In November 2019, the Indian Government announced new rules involving section 227 of the IBC. Section 227 grants India's federal government the power to notify financial service providers of their insolvency and liquidation proceedings, which may now be conducted under the IBC. These rules provide that the Government may refer cases of shadow banks with assets of at least five billion rupees to insolvency court under the IBC.

The new rules and amendments for shadow banks came too late for IL&FS. The Government instead has continued its out of court piece-meal liquidation of IL&FS.

The need to address shadow banks became urgent after financial difficulties infected Dewan Housing Finance Corporation Ltd. ("DHFL"), prompting the new rule for shadow banks. This shadow bank, a direct competitor of IL&FS, saw the Reserve Bank of India (RBI) initiate formal bankruptcy proceedings against it under the IBC on November 29, 2019, after it defaulted on various payment obligations. In total, DHFL owes creditors almost 1 trillion rupees (US\$14 billion). The creditors include mutual funds, banks, pension funds, insurance firms, and retail investors.

DHFL will be the first financial institution to test the effectiveness of the IBC with respect to a shadow bank restructuring. Moreover, with IL&FS still being handled out of court, DHFL is the largest corporate insolvency resolution process ever in India since the IBC went into effect in December 2016.

The new rules bringing shadow banks under the umbrella of the IBC are not the only newly enacted bankruptcy laws in India. On August 5, 2019, the IBC (Amendment) Act, 2019, received presidential approval. The Act made many key changes and additions to the IBC. The most notable adjustments included (a) increasing the timeline for the corporate insolvency resolution process from 270 days to 330 days, (b) mandating that operational and dissenting creditors not receive less in a resolution than they would in a liquidation (akin to the best interests of creditors rule in the US and other jurisdictions), and (c) making the resolution plan binding on all stakeholders. These changes include aspects designed to both protect creditors and enable restructurings to succeed.

Whether and how the new rules will work to preserve DHFL and other distressed shadow banks remains an open question that will have repercussions throughout the Indian economy. Thus far, results for corporate businesses generally under the IBC have been anything but consistent. Of the approximately 2,500 cases that have been admitted into the corporate insolvency resolution process from 2016 through September 2019, almost 1,500 are ongoing. Of the cases that have closed, only 15% have done so by resolution, i.e. a restructuring plan. The majority of cases have closed by liquidation, while others were settled or withdrawn.

Though the adjustments to the IBC may be too recent to measure their relative success, India appears set on facilitating the revival of corporate debtors by encouraging a resolution and preventing lengthy delays. When considered with the new rules passed in August and November 2019, indications are that India is seeking to move its bankruptcy laws towards improved predictability and effectiveness, with the hopes of insuring continued lending and investment and the fair resolution of distressed companies.

The jury is still out, but stay tuned for further developments regarding how both commercial enterprises and shadow banks fare under this new insolvency regime in India.

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