NORTON ROSE FULBRIGHT

International Restructuring Newswire

A quarterly newsletter from the global restructuring team at Norton Rose Fulbright

Q4 2022

In this issue:

To our clients and friends

Alto Maipo: Delaware ruling poses jurisdictional challenges for Chapter 11 debtors

Financial crime in an economic downturn: tracing assets through beneficial ownership

2022 brings continued disagreement among US courts as to the validity of third party releases in US Chapter 11 plans

Momentum towards lowering Canada's criminal rate of interest?

Contents

To Our Clients and Friends 03

In the News 04

Feature articles

Alto Maipo: Delaware ruling poses jurisdictional challenges for Chapter 11 debtors 06

Financial crime in an economic downturn: tracing assets through beneficial ownership 10

2022 brings continued disagreement among US courts as to the validity of third party releases in US Chapter 11 plans 14

Momentum towards lowering Canada's criminal rate of interest? 18

International Restructuring Newswire

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Published by Norton Rose Fulbright – Q4 2022 – Issue 19

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To our clients and friends:

As we publish our fourth quarter edition of the Newswire, global economic challenges abound. The International Monetary Fund last week warned that the world economy is heading toward a potentially severe recession as central banks aggressively raise interest rates, Russia's war in Ukraine continues, and supply chain disruptions persist.

In its World Economic Outlook report, the IMF lowered its global growth forecast for next year in the face of "steep challenges" and warned that "the worst is yet to come" for many countries. "Risks to the outlook remain unusually large and to the downside…while global tightening in financing conditions could trigger widespread emerging market debt distress."

With the IMF's warning ringing in our ears, in this issue we attempt to grapple with some of the knottier issues facing the restructuring landscape. We look at a recent decision in Delaware that impacts the ability of foreign companies to restructure in the US, Australian laws dealing with financial crimes in an economic downturn, and proposals in Canada to regulate high cost loans.

Our readers will also note in this issue that we have changed the name of our group from Financial Restructuring and Insolvency to the simpler title of Restructuring. We believe this new name more clearly reflects our group's broad mandate to handle the gamut of matters from out-of-court restructurings to more formal judicial proceedings. Other than the name change, our group remains hard at work advising our clients on issues brought on by the ongoing economic turmoil.

Good reading,

Howard Seife
Global Co-Head of Restructuring

Scott Atkins
Chair, Australia
Global Co-Head of Restructuring

In the news

Norton Rose Fulbright Appoints Scott Atkins as Global Co-Head of Restructuring

Scott Atkins has been appointed Global Co-Head of Restructuring, alongside US-based partner **Howard Seife**. Scott has a long history of advising on international matters. He is president and an inaugural fellow of INSOL International, as well as chair of INSOL's Asian Advisory Council. Scott is also chair and head of risk advisory for our firm in Australia.

INSOL International – Young Practitioner Spotlight

Jenna Scott, Kellie Link and **Candy Lau (Australia), Eric Daucher (New York)** and **Koen Durlinger (Amsterdam)** have been recognized in INSOL's Young Practitioner Spotlight. The Spotlight is a supplement to the Q3 2022 issue of *INSOL World* magazine and seeks to highlight young talent in the international insolvency and restructuring community.

Canadian Association of Insolvency and Restructuring Professionals

Jennifer Stam was appointed to the board of directors of the Canadian Association of Insolvency and Restructuring Professionals, Canada's preeminent association for the education, standards and advocacy of insolvency and restructuring professionals.

ABLI-III Restructuring Project

Scott Atkins has provided feedback as an invited external consultant on the *Guide to Out of Court Workouts in Asia*, currently being developed by the Asian Business Law Institute and the International Insolvency Institute.

Company Directors – Navigating Troubled Waters

July 27, 2022
Noel McCoy, in collaboration with The Ross Parsons Centre (University of Sydney), moderated a panel on navigating businesses through unexpected challenges and distress and managing the risk of personal liability for directors.

RITANZ Conference

August 10, 2022

Laura Johns presented alongside contacts from Russell McVeagh on restructuring techniques in Australia, New Zealand and abroad.

International Insolvency Institute -- NextGen Conference

September 8, 2022
Prof. Omar Salah was invited to speak at the NextGen Conference at the Annual Conference of the International Insolvency Institute (III) in Toronto, Canada. He spoke on how to anticipate financial distress and avoid insolvency. The panel covered this topic from both a legal as well as a financial perspective.

Singapore International Commercial Court – INSOL International Asia Conference

September 22, 2022
Scott Atkins delivered a keynote address outlining future challenges and opportunities in cross-border insolvency and Singapore's efforts to become a global restructuring hub, including via the recent expansion of the SICC's jurisdiction and procedural rules.

INSOL International

September 22, 2022
Scott Atkins delivered a training session for judges of the Supreme Court of Brunei, focusing on regional restructuring and insolvency policy and practice developments, as well as cross-border recognition, cooperation and harmonisation.

Annual Academic Conference of INSOL Europe

October 6, 2022

Prof. Omar Salah was invited to speak at the Annual Academic Conference of INSOL Europe in Dubrovnik, Croatia. He spoke about the pre-pack in the Netherlands and throughout Europe, focusing on recent case law from the European Court of Justice. He also addressed how this relates to the European Restructuring Directive.

ARITA National Conference 2022

October 26–27, 2022

Jonathon Turner will co-lead a professional development workshop titled “Remuneration Masterclass” at the annual ARITA conference.

Law Council of Australia, Insolvency & Restructuring Committee Conference

October 28, 2022

Natasha Toholka will present with panellists from Allens Linklaters and Thomson Geer on insolvency practitioner liability.

2022 TMA Annual Conference

November 1-4, 2022

Jason Boland will moderate a panel at Turnaround Management Association’s annual conference in Boston. The panel topic is “Industry Titans Spill the Tea.”

Dutch Restructuring Association

November 3, 2022

Prof. Omar Salah will be chair of a panel on distressed investment during the Annual Conference of the Dutch Restructuring Association. The panel will deal with restructuring from the perspective of an investor. The speakers will cover both distressed debt investments as well as distressed equity investments.

Webinar: Sustainability in Distressed Times: A Discussion on ESG and Insolvency

November 9, 2022

Norton Rose Fulbright will host a webinar featuring **Jennifer Stam, Scott Boucher, Evan Cobb** and **Alison Babbitt** who will discuss the important legal and practical considerations of the intersection between ESG and insolvency.

41st Annual Jay L. Westbrook Bankruptcy Conference

November 18, 2022

Ryan Manns will speak on a panel at the annual Jay L. Westbrook bankruptcy conference in Austin, Texas. His panel will discuss the roles of independent directors in overseeing, formulating and negotiating a debtor’s restructuring.

Global Restructuring Review

Andrew Rosenblatt and **Jason Blanchard** co-authored an article, “Alto Maipo: Delaware ruling poses jurisdictional challenges for Chapter 11 debtors,” published September 30 , 2022 in the *Global Restructuring Review*.

Omar Salah and **Sylwia Maria Bea** were featured in an article, “Fuelling distress: Europe’s €500 billion energy crisis,” published September 30, 2022 in the *Global Restructuring Review*.

Scott Atkins’ article “Ready for lift off: exploring restructuring opportunities in outer space” was profiled in the *Global Restructuring Review* on October 6, 2022.

Scott Atkins provided commentary on the current review being undertaken into Australia’s corporate insolvency regime – “ Lawyers welcome review of Australia’s corporate insolvency regime,” published October 11, 2022 in the *Global Restructuring Review*.

Alto Maipo: Delaware ruling poses jurisdictional challenges for Chapter 11 debtors

Andrew Rosenblatt and Jason Blanchard

Under Chapter 11 of the US Bankruptcy Code, a debtor may generally assume an executory contract if it cures any monetary defaults and provides adequate assurance of future performance. But in a case of first impression in the restructuring of Chilean hydroelectric plant operator Alto Maipo, the US Bankruptcy Court for the District of Delaware imposed an additional requirement for contract assumption, finding that it must have personal jurisdiction over the contract counterparty.

In rendering its decision, the court acknowledged the assumption of an executory contract is ordinarily an *in rem* proceeding and thus personal jurisdiction would typically not be relevant. In this instance, however, the debtors requested specific findings regarding defaults and cure amounts under the contract that necessarily implicated *in personam* considerations. Thus, the court declined to consider the motion absent the commencement of a separate adversary proceeding with its attendant constitutional safeguards.

The decision may have serious implications, principally on foreign debtors that file Chapter 11 cases in the US. Foreign debtors are more likely than US debtors to have contract counterparties with limited or no contacts with the US that can raise valid personal jurisdictional challenges. As a result, before commencing Chapter 11 proceedings, debtors with foreign contract counterparties should be mindful of potential jurisdictional challenges that could preclude contract assumption or make assumption unusually time-consuming and costly.

Unsustainable capital structure

Alto Maipo is a special purpose company incorporated under Chilean law. The company was formed in 2011 to develop, construct, and operate several hydroelectric energy plants and related facilities in the Andes Mountains, approximately 30 miles southeast of Santiago. The plants became operational earlier this year and are expected to provide a significant source of zero-emissions energy to Chile's electrical grid.

Soon after construction began, the company experienced unexpected construction delays. According to the company, the delays increased project costs precipitating two out-of-court restructurings that significantly increased the amount of debt Alto Maipo owed to creditors. Later shifts in supply and demand in the energy market exacerbated the company's financial distress. In the company's Chapter 11 filings, the company claimed the events caused Alto Maipo's capital structure to become unsustainable and it filed Chapter 11 cases along with its US affiliate, Alto Maipo Delaware, in Delaware in November 2021.

Pursuant to a committed power purchase agreement (PPA) with Chilean company Minera Los Pelambres (MLP), Alto Maipo agreed to sell energy generated at the plants to MLP at predetermined rates. The debtors anticipated that MLP's PPA commitment would cover nearly half of the project's energy output every year for nearly two decades. Indeed, the debtors said Minera Los Pelambres' desire to preserve the value of the PPA was one significant reason for filing for Chapter 11 protection. Moreover, the debtors' maintenance of the PPA was an integral component of a restructuring support agreement that embodied the terms of a consensual restructuring, which was agreed to by the debtors and key creditor constituencies. In fact, the rejection or termination of the PPA would allow for creditors to terminate their commitment to the consensual restructuring.

Alto attempts to assume the PPA

In furtherance of the consensual restructuring, the debtors filed a motion to assume the PPA. According to the debtors, the PPA was essential to maximising the value of their estates: the PPA provided a locked-in revenue stream from a creditworthy counterparty upon which the debtors' business plan and revenue projections relied, it freed the debtors from the need to market, negotiate, and maintain other contracts for the project's energy outputs, and it alleviated the effects of market cycles and price fluctuations on the debtors' revenues. Moreover, maintenance of the PPA was a negotiated

component of the restructuring and its assumption was a condition precedent to the effectiveness of the debtors' plan. For these reasons, the debtors contended that assuming the PPA was a proper exercise of their business judgement.

The PPA contained a provision allowing MLP to terminate the agreement if Alto Maipo was declared to be in liquidation, requested its own liquidation, or filed a reorganisation proceeding in Chile. During the cases, MLP sent letters to the debtors claiming the termination provisions had been triggered by filing for Chapter 11. The debtors disagreed and asserted that MLP did not have a right to terminate the PPA because Alto Maipo was not liquidating and the company had not commenced reorganisation proceedings in Chile. They also argued the insolvency provisions amounted to an unenforceable ipso facto clause. On these grounds, the debtors claimed no defaults had occurred and sought the court's determination that no cure amounts should be paid to MLP. They requested specific findings from the bankruptcy court that the filing of the Chapter 11 cases did not trigger the termination provisions of the PPA, constitute a liquidation or reorganisation within the meaning of the PPA and Chilean law, or qualify as an act of bad faith under the PPA that would permit MLP to terminate the PPA.

MLP filed a limited response and reservation of rights solely for the purpose of objecting to the sufficiency of service and notice of the assumption motion based on MLP's status as a foreign entity. It also disputed the bankruptcy court's authority to grant the requested relief without first establishing personal jurisdiction over MLP.

Jurisdictional dispute

Before examining the parties' jurisdictional arguments, an overview of the bases for the bankruptcy court's jurisdiction over a debtor's property is necessary. Section 1334(e) of Title 28 of the United States Code provides that the district court, and derivatively, the bankruptcy court, "shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of [the] case, and of property of the estate." "Property of the estate" is with few exceptions comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case" wherever such property is located and by whomever it is held.

Courts have interpreted these sections to mean that Congress explicitly granted bankruptcy courts global *in rem* jurisdiction over the debtor's property.

In rem relief, the type of relief typically sought from bankruptcy courts, generally concerns enforcement of obligations against or rights to property, regardless of the persons involved. Indeed, the US Supreme Court has often stated that bankruptcy jurisdiction "is principally *in rem* jurisdiction." By contrast, *in personam* relief generally seeks to impose an obligation or liability on a person. It typically does not concern ownership of or rights in or to property of the estate.

Courts evaluate *in personam* jurisdiction by looking at a defendant's minimum contacts with the forum and whether the defendant was properly served. Depending on the specific relief sought, courts may require both *in personam* and *in rem* jurisdiction. For example, a bankruptcy court must have *in rem* jurisdiction to approve a sale of assets under section 363 of the US Bankruptcy Code, and *in personam* jurisdiction to grant additional relief binding on the purchaser and other parties in interest in connection with the sale.

Turning to the parties' arguments, MLP did not contend that the bankruptcy court lacked *in rem* jurisdiction over the PPA. Rather, MLP argued that the debtors were seeking *in personam* relief because the motion sought an adjudication of MLP's particularised rights and obligations under the PPA, particularly whether a breach had occurred based on the Chapter 11 filings. Therefore, MLP reasoned that the court's jurisdiction depends on whether MLP's minimum contacts with the US were sufficient to satisfy due process. Because the PPA is between Chilean parties, governed by Chilean law, includes a Chilean arbitration dispute-resolution provision, and relates to a Chilean project, MLP argued the dispute did not arise out of contacts MLP has with the U.S. and therefore the court lacked personal jurisdiction over it.

The debtors and lenders principally argued that the assumption of the PPA is purely an *in rem* matter regarding property of the estate, i.e. a contract, and related enforcement rights, and therefore falls squarely within the bankruptcy court's power to adjudicate. Separate from *in rem* jurisdiction, bankruptcy courts have subject matter jurisdiction over all proceedings "arising under" the Bankruptcy Code. Pointing to the lack of case law supporting MLP's position, the debtors and lenders argued that, under the plain language of section 365 of the Bankruptcy Code, *every* debtor that seeks to assume an executory contract must cure all existing defaults. Thus, in *every* contract assumption motion, a bankruptcy court must determine whether a default has occurred regardless of whether it has personal jurisdiction over the contract counterparty.

According to the debtors and lenders, taking MLP's argument to its logical conclusion would require bankruptcy courts to determine personal jurisdiction over contract counterparties in *every* motion to assume an executory contract. This could result in the transformation of a summary proceeding intended for the efficient review of a debtor's business judgement decision to assume a particular contract into a lengthy trial with disputed issues and prolonged discovery.

Personal jurisdiction required

Following oral argument, the court issued its ruling from the bench in April 2022. It began by stating that the assumption motion sought more than a determination of the debtor's business judgement because it seeks specific findings that no default had occurred under the PPA and thus no cure amounts were owed to MLP. The court reasoned it would need to determine the parties' rights under the PPA to make those findings – akin to deciding a breach of contract action, a quintessentially *in personam* action. The court acknowledged that the adjudication of whether a debtor has exercised proper business judgement to assume a contract is ordinarily a summary *in rem* proceeding that does not require personal jurisdiction. But, in the court's view, the requested findings went beyond just that and the court ruled it would not adjudicate the assumption motion without an adversary proceeding and establishment of personal jurisdiction over MLP.

Notably, the court declined the debtors' invitation to remove most of the proposed findings and retain those related to whether the insolvency language in the PPA amounts to an unenforceable ipso facto clause. In the court's view, this too would still require adjudication of MLP's rights under the PPA rather than the estate's property rights. The court also emphasised that the facts in the case were different than those in a traditional assumption situation given the court's view that the controversy concerned a pending contract dispute involving a foreign counterparty.

New tool for foreign counterparties?

The *Alto Maipo* decision provides foreign counterparties in cross-border Chapter 11 cases with a potential tool to contest the assumption of their contracts. Though the court viewed the facts of the dispute to be unique, foreign companies holding foreign contracts frequently file for Chapter 11 to assume those contracts under section 365 of the Bankruptcy Code.

It is not uncommon for there to be disputes related to those contracts. Here, the court was persuaded that it needed personal jurisdiction over MLP based on the specific findings requested by the debtors that related directly to the parties' contract dispute. However, the decision raises red flags because a bankruptcy court must determine, with respect to every assumption motion, whether a default has occurred and, if so, the proper cure amount. This begs the question of whether the court would have ruled differently had the proposed findings been pared down and limited solely to confirming satisfaction of the statutory requirements for assumption of the contract.

Andrew Rosenblatt is a partner in our New York office and Jason Blanchard is senior counsel in our Dallas office in the firm's global restructuring group.

This article first appeared in the September 30, 2022 edition of *Global Restructuring Review* and is reprinted with the permission of Law Business Research.

Financial crime in an economic downturn: tracing assets through beneficial ownership

Scott Atkins and Jeremy Moller

Australia's *AntiMoney Laundering and CounterTerrorism Financing Act 2006* (Cth) (AML Act) requires regulated entities to identify and verify customers and their beneficial owners. The rationale for this requirement is that identifying the true owner of an asset enables the regulated entity, Australian Transaction Reports and Analysis Centre (AUSTRAC) and law enforcement, to investigate, confiscate and prosecute the movement of the proceeds of crime.

AML has become increasingly relevant for regulated entities in Australia in the last few years, given the enforcement actions taken against reporting entities for breaches of the AML Act and the associated media scrutiny and reputational damage. As a consequence, methods for conducting due diligence by regulated entities into their customers and counterparties, including who really owns them, is being used in assessing credit risk and, if necessary, tracing of assets.

Asset tracing

Australian entities and persons who may be victims of financial crime have available to them various civil options to pursue recovery of their assets.

Tracing is the process by which the original owner of property can identify assets that may be physically retained or registered in the name of another party because of some kind of misappropriation or misuse of property. The law of tracing determines when one right stands in the place of another for the purposes of being able to bring certain legal or equitable claims. Australian Courts provide a number of remedies to recover money or personal property that is wrongly in the hands of a third party. These include:

- A declaration of a constructive trust
- A declaration of an equitable lien
- An account of profits and damages

These remedies will often be supported by freezing orders (previously known as Mareva injunctions) or search orders (previously known as Anton Piller orders) to ensure misappropriated property is not lost or dissipated pending determination of the ownership dispute in the Courts. Both types of interim orders can be obtained quickly if a court is satisfied it is appropriate.

However, before seeking these orders, which can have very serious consequences for those who are subject to them, a party will typically need to undertake due diligence to identify where property is and who is holding it. This can be time consuming and can deter potential applicants. Yet the methods for obtaining publically available information, when conducting due diligence under the AML Act, can also be used to aid tracing, whist reducing the cost burden of doing so. Increasingly, such information is being used to go beyond traditional KYC (Know Your Customer) to KYT (Know Your Transaction), by assessing who may be the recipient of a payment or asset, enabling Know your Counterparty.

Sources of due diligence

Under the AML Act regulated entities are required to identify and verify customers and their beneficial owners. For some customers, which pose a higher risk of money laundering, this includes a requirement to identify the source of funds and source of wealth of the customer.

Under the AML Act, a beneficial owner is an individual who ultimately owns or controls an entity such as a company, trust or partnership. 'Owns' in this case means owning 25% or more of the entity. This can be directly (such as through shareholdings) or indirectly (such as through another company's ownership or through a bank or broker).

Due diligence can be obtained from multiple sources accessible to the public, some of which may incur a fee:

1. Australian Securities and Investments Commission (**ASIC**) – all companies and other disclosing entities are required to prepare and lodge annual financial reports, which may include some details of the entity's assets. This also includes the directors and shareholders of the company.

2. Australian Stock Exchange (**ASX**) – publically listed companies are required to make market disclosures, including annual reports and other documents detailing financial performance.
3. Land title searches – ownership of land is required to be registered under State title regimes. Various entities can provide searches of these registers.
4. Personal Property Securities Register (**PPSR**) – information may also be available on the PPSR, which is the national register for all security interests attached to personal property.

These are publically available sources of information, which can be utilised to avoid potential privacy issues that can be associated with the use of other sources of information. However, publically available information has limitations in terms of identifying the ultimate beneficiaries of assets. But this may be set to change with the proposed introduction of a beneficial ownership register in Australia and a similar register in the United Kingdom for overseas property owners.

Freezing orders

The Basel Institute on Governance has produced 'Tracing Illegal Assets – A Practitioner's Guide' that devotes a chapter to using the AML for asset tracing. One example detailed in the chapter is the use of freezing orders as a provisional measure applicable to bank accounts and other financial products, which prevents the nominative owner of such products from moving, transferring or converting these assets, including overseas.[1]

In the Australian matter of *HPack Investments Pty Limited* [2020] NSWSC 1638, the Deputy Commissioner of Taxation (**Commissioner**) had begun winding up proceedings against HPack Investments Pty Ltd (**HPack**) in respect of unpaid tax in the amount of approximately AUD$20 million. Based on the Commissioner's investigation into the affairs of HPack and its directors it appeared that:

1. In assessing the underlying bank records, it showed that payments to HPack had substantially reduced in the 36 months prior to March 2020, with the consequence that HPack's assets could not meet a claim by the Commissioner;
2. Its directors may have breached their duties to the company by arranging for the payment of substantial amounts either to themselves or for their benefit; and
3. The directors transferred a large amount of cash by electronic funds transfers to their relatives, in particular their sons, and bank accounts outside of Australia.

Relying on the above, the Commissioner argued that claims which a liquidator of HPack could pursue against its directors may be frustrated, because the directors had transferred the benefit of these payments to third parties and outside of Australia.

The relief sought by the Commissioner was a freezing order in respect of the directors' assets. In making of a freezing order, Black J summarised the relevant principles at paragraph 37: *"a freezing order is intended to prevent the abuse or frustration of the processes of the Court by preventing a defendant from disposing of its assets so as to deprive a plaintiff of the fruits of any judgment obtained in the proceeding."*

At paragraph 48 Black J concluded the Court does have requisite jurisdiction to make a freezing order that will preserve the claims that may be brought by a liquidator appointed to HPack: *"That order is, in my view, directed to preventing the frustration or inhibition of the Court's winding up process by seeking to meet a danger that a prospective judgement that could be obtained by a liquidator consequent on that process will be wholly or partly unsatisfied."*

Greater beneficial ownership transparency in Australia

Recently the new Labor Government released its paper regarding 'Multinational tax integrity and enhanced tax transparency'[2] in which it announced that it will implement a public registry of beneficial ownership to improve transparency on corporate structures, in order to show who ultimately owns or controls a company or other legal entity. This follows the Senate Standing Committee on Legal and Constitutional Affairs (**Committee**) Inquiry into the Adequacy and Effectiveness of the AML/CTF (**Inquiry**). The Committee made recommendations prior to the May 2022 election, that the Commonwealth Government should pursue a beneficial ownership register.

The Law Council of Australia conveyed to the Inquiry that if ASIC collected beneficial ownership information in the annual statement for Australian companies and made this information available it would reduce the regulatory burden imposed on regulated entities under the AML Act. Additionally, the Australian Taxation Office could perform a similar function for trusts with an ABN, as part of the annual reporting obligation of the trusts.

The Committee in handing down the Inquiry Report acknowledged that the development of a robust beneficial ownership register would both mitigate the burden on small business by enhancing and simplifying KYC searches and at the same time would reduce Australia's vulnerability to money laundering.

1 Basel Institute on Governance, 'Tracing of Illegal Assets', 2019 (https://baselgovernance.org/sites/default/files/2019-01/tracing_illegal_assets_EN.pdf), page 102.

2 Australian Government Treasury, 'Government election commitments: Multinational tax integrity and enhanced tax transparency – Consultation Paper', August 2022, (https://treasury.gov.au/sites/default/files/2022-08/c2022-297736-cp.pdf).

United Kingdom Register of Overseas Entities

In order to combat similar concerns, the UK recently introduced the Register of Overseas Entities on 1 August 2022 through the new *Economic Crime (Transparency and Enforcement) Act 2022* (UK). The legislation requires overseas entities who want to buy, sell or transfer property or land in the UK, to register with Companies House, including who their registrable beneficial owners or, if there are none, who their managing officers are. Importantly the provisions apply retrospectively to overseas entities who bought property or land on or after 1 January 1999 in England and Wales or 8 December 2014 in Scotland and registration is mandatory by 31 January 2023.

There will be sanctions for those who do not comply, including restrictions on buying, selling, transferring, leasing or charging their land or property in the UK.

In the UK a beneficial owner includes an individual, company, government or public authority or trustee. There is a specific 'natures of control' test, which determines registration. Guidance as to how to apply this test is available on the UK Government website and summarised here.[3]

The Register of Overseas Entities is a further publicly available resource to aid parties in tracing of assets. It is particularly helpful in that it can assist with understanding where assets have been moved cross border (outside of Australia), but also where it is owned by foreign nationals. London as a centre for finance and commerce has a greater proportion of foreign owned property so imposing such measures is designed to increase transparency and reduce the likelihood of illicit funds entering the economy. We continue to monitor the introduction of similar sources in other jurisdictions.

Conclusion

Beneficial ownership registers and existing AML due diligence are increasingly becoming a valuable resource to aid asset tracing. Where appropriate, advice should be sought when considering freezing or search orders, assessing potential risks in dealing with the proceeds of crime, or making reports to regulators such as the AUSTRAC and/or law enforcement. Balancing the potential for recovery and regulatory impost are important considerations when tracing assets. A first step is typically to undertake an assessment of existing due diligence to determine the cost-benefit analysis of taking further action.

Scott Atkins is co-head of restructuring and head of risk advisory and Jeremy Moller is a senior advisor–risk advisory, both in our Sydney office.

3 UK Government, 'Register an overseas entity and tell us about its beneficial owners', published 25 July 2022 (https://www.gov.uk/guidance/register-an-overseas-entity).

2022 brings continued disagreement among US courts as to the validity of third party releases in US chapter 11 plans

Michael Berthiaume and Maria Mokrzycka

A third party release in an insolvency proceeding refers to a release that is given to a non-debtor party that prevents that released party from being sued by creditors of the debtor. There are two types of third party releases in insolvency cases—voluntary and involuntary. For instance, voluntary third party releases are those to which a releasing creditor has consented. by agreeing to the release on its plan ballot. On the other hand, involuntary third party releases release a non-debtor without consent of the creditors. Third party releases in insolvency cases are generally used to facilitate a settlement between a debtor and its stakeholders by preventing certain claims from being asserted against the released parties after confirmation of the debtor's plan of reorganization. The usefulness of these releases is apparent in contentious restructurings; indeed, many countries (including England and Canada) regularly permit creditors to release their claims against non-debtor third parties.[1]

United States courts, however, are divided on the question when considering chapter 11 cases. The Fifth, Ninth and Tenth Circuit Courts of Appeal have entirely rejected third party releases outside of asbestos-related cases where the US Bankruptcy Code explicitly allows such releases. In comparison, the First, Third, Fourth, Sixth, Seventh, Eighth, Eleventh and DC Circuit Courts of Appeal have found the releases to be authorized under various sections of the Bankruptcy Code and under a bankruptcy court's "residual authority." Despite their authorization of third party releases, even those courts use phrases like "extraordinary," "unusual" and "when circumstances warrant" in defining their applicability.[2]

Continuing to fuel this uncertainty, courts in 2022 have issued significant but divergent decisions on the use of third party releases in chapter 11—either striking down plans on the grounds that bankruptcy courts do not have the requisite authority to approve such releases or, on the other hand, finding the requisite authority and approving the use of such third party releasesT. his uncertainty, coupled with legislation now before the US Congress, indicates that nonconsensual third party releases are now in the cross-hairs. As a result, parties that are using (or might use) US courts to restructure their liabilities where third party releases are needed should pay close attention to these shifting views as they consider their strategic options. We discuss below the 2022 decisions reaching different decisions on this important topic.

The Eastern District of Virginia (*In re Ascena Retail Group*) deals another blow to third party releases

In January 2022, the US District Court for the Eastern District of Virginia vacated the confirmation order that was on appeal in *Patterson, et al. v. Mahwah Bergen Retail Group, Inc.*, on the ground that the plan contained impermissible non-consensual third party releases. 636 B.R. 641 (E.D. Va. 2022) ("Ascena Retail Group"). Ascena Retail Group was a publicly held retailer of apparel for women and girls that filed for bankruptcy in 2020 and owned brands such as Ann Taylor, LOFT, Lane Bryant and Lou & Grey. The debtors liquidated their assets through a series of sales and proposed a plan

1 For example, Canadian courts see third party releases as an important aspect of the restructuring process. Accordingly, it is well-established in Canada that insolvency courts have the jurisdiction necessary to approve a plan of compromise or arrangement that includes releases in favor of non-debtor third parties, including releases that are binding on parties beyond the jurisdiction of the granting court. Canadian restructuring plans, including such non-debtor third party releases, have further been recognized by US courts pursuant to chapter 15 of the US Bankruptcy Code.

2 The Second Circuit Court of Appeals was thought by many to have previously indicated that non-consensual third party releases of claims against non-debtors could be approved in "appropriate, narrow circumstances." *Deutsche Bank A.G. v. Metromedia Fiber Network, Inc., (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 141 (2d Cir. 2005). That view, however, was upended last year by a December 2021 decision from the Southern District of New York determining that the Second Circuit Court of Appeals had not directly addressed whether the Bankruptcy Code provided the requisite authority to grant non-consensual third party releases and holding that the Bankruptcy Code, in fact, did not so provide. Accordingly, in that decision, the releases were denied.

providing for the distribution of the estate's remaining cash to creditors, which the Bankruptcy Court confirmed (the "Ascena Plan").

The Ascena Plan also included the usual broad third party releases, covering any type of claim that existed or could have been brought against any person or entity associated with the debtors as of the effective date of the Ascena Plan, including a securities fraud class action lawsuit then pending against certain prepetition executives of Ascena. The releases bound anyone that did not affirmatively "opt out" of such releases in a plan ballot. Because creditors had the ability to opt out of the third party releases in connection with their plan ballot, the Bankruptcy Court treated the releases as "consensual." Following confirmation, the United States Trustee and the securities fraud litigation plaintiffs appealed the bankruptcy court's decision to the District Court.[3]

The District Court first conducted an extensive analysis of whether the Bankruptcy Court has jurisdiction to determine the released claims, including the class action lawsuit, and determined that the court lacked <u>constitutional</u> authority to grant the releases. The District Court criticized the Bankruptcy Court for (i) not identifying whether it had jurisdiction over the claims the plan released, and (ii) not engaging in a content-based analysis of whether the claims being released were core or non-core, as required by *Stern v. Marshall,* 564 U.S. 462 (2011), the US Supreme Court case establishing that US Bankruptcy Courts may only determine "core" bankruptcy claims that fall within the constitutional grant bestowed by Article I of the US Constitution. The District Court found that many of the claims being released by the plan, including several claims in contract and tort that arose prior to the debtors' petition, had no bearing on the property of the debtors' estate or the administration of the case. As

3 The District Court ultimately determined that the securities litigation plaintiffs lacked standing to appeal because they opted out of the release and, therefore, the releases had no impact on them. The United States Trustee, however, was allowed to proceed. *Mahwah Bergen Retail Group, Inc.*, 636 B.R. at 663–64.

a result, the District Court concluded that these claims clearly did not constitute "core" matters with respect to the debtors' bankruptcy case. Thus, the Bankruptcy Court lacked jurisdiction to determine such claims and as a result lacked the power to release the claims absent the consent of the releasing parties.[4]

Second, the District Court found that the releases were not consensual, noting that the Bankruptcy Court did not consider the proper threshold question in determining whether the releases were consensual; rather, the Bankruptcy Court looked only to whether a releasing party had returned the required "Release Opt-Out Form" (if not, the release would automatically be deemed consensual). The District Court rejected that approach, holding that the US Bankruptcy Code requires an overt act—such as affirmatively "opting in" to the release—evidencing the party's consent to resolve the claim. Inaction in the form of failing to opt out of a release was insufficient given the constitutional standard for active, knowing and voluntary consent.

As a result of the District Court's decision, the debtors sought confirmation of a modified Ascena Plan without the third party releases invalidated by the District Court. The modified Ascena Plan was ultimately confirmed by the Bankruptcy Court on March 3, 2022.

Delaware Bankruptcy Courts continue to approve third party releases

In February 2022, the US Bankruptcy Court for the District of Delaware (Bankruptcy Judge Dorsey) confirmed a plan in *In re Mallinckrodt* that contained non-consensual third party releases. *See In re Mallinckrodt PLC,* 639 B.R. 837 (Bankr. D. Del. 2022) ("Mallinckrodt"). Mallinckrodt and its debtor affiliates produced and sold a variety of pharmaceutical products, including opioids. Mallinckrodt filed its bankruptcy case to settle numerous lawsuits in connection with its production of opioids, and its plan provided four different types of releases: (a) releases by the debtors; (b) releases by non-debtor third parties where certain claimants were given a chance to "opt out" of third party releases; (c) non-consensual releases by opioid claimants; and (d) releases by the debtors and affiliates of the opioid claimants. Although the Plan was overwhelmingly supported by the creditors, the US Trustee, the SEC, and the State of Rhode Island objected to different releases. The objectors argued that the releases were "vastly overbroad, releasing persons and entities that did not contribute anything of value to the reorganization." The US Trustee also argued that the Bankruptcy Court lacked jurisdiction to approve the releases and that creditors' due process rights would be violated.

While acknowledging *Ascena* and other cases, Bankruptcy Judge Dorsey concluded that under precedent in the Third Circuit Court of Appeals (which covers Delaware), the Bankruptcy Court had the requisite authority to approve the non-consensual opioid releases. He remarked, "[t]here can be no debate over the proposition that a bankruptcy court can approve a plan that includes third party releases" in the Third Circuit.[5] First, Judge Dorsey determined the Bankruptcy Court possessed constitutional authority because these releases were integral to the success of the debtors' plan; therefore, they were a core matter. Judge Dorsey reasoned that without the releases, settlements that were essential to the plan would not be effectuated and, without the settlements, the plan would fall apart.

Second, Judge Dorsey—in contrast to the District Court in *Ascena*—found that the opt-out provisions of the third party releases rendered them consensual. In making this determination, Judge Dorsey examined the extent of the notice given and found ample evidence in the record that the debtors made every effort to ensure that the releasing parties were sent notices in a variety of ways that clearly explained in "no uncertain terms" that action was required to preserve claims. The Mallinckrodt Plan went effective on June 16, 2022, although some issues unrelated to the releases remain on appeal to the Third Circuit Court of Appeals.

Most recently, the Delaware Bankruptcy Court (Bankruptcy Judge Silverstein) confirmed a plan in *In re Boy Scouts of America and Delaware BSA, LLC*, No. 20-10343, 2022 WL

4 The District Court explained that the Bankruptcy Court only "stated in conclusory fashion" that the third party releases were integral to the plan, basing this finding only "on the fact that the Plan stated as much." Instead, the Bankruptcy Court should have made specific findings of fact to determine whether it was justified in approving a third party release. The District Court specifically found that the Bankruptcy Court had not conducted the proper seven-factor test adopted by the Fourth Circuit Court of Appeals, (that is binding precedent in the Eastern District of Virginia), which requires all of the following**:** "(1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full; and (7) The bankruptcy court made a record of specific factual findings that support its conclusions." *Mahwah Bergen Retail Group, Inc*., 636 B.R. at 681 (citing *Behrmann v. Nat'l Heritage Found*., 663 F.3d 704, 711–12 (4th Cir. 2011)).

5 In making this determination, Judge Dorsey cited *In re Millennium Lab Holdings II, LLC*, 575 B.R. 252 (Bankr. D. Del. 2017) *aff'd* 945 F.3d 126 (3rd Cir. 2019) *cert denied* 140 S.Ct. 2805 (2020). But, *Millennium* only stands for the proposition that a Bankruptcy Court possesses constitutional authority to approve non-consensual third party releases and does not directly address whether the US Bankruptcy Code provides a statutory mechanism to do so.

3030138 (Bankr. D. Del. Jul. 29, 2022) ("Boy Scouts"). In *Boy Scouts*, Bankruptcy Judge Silverstein followed the Third Circuit's opinion in *Millennium* to determine that "a bankruptcy court has both statutory and constitutional authority to enter a final order confirming a plan containing non-consensual third party releases . . . ." Specifically, Judge Silverstein agreed with Judge Dorsey's decision in *Mallinckrodt* that opt-out provisions make such a release consensual and further, that nonconsensual releases fall within the Bankruptcy Court's constitutional authority where the release is "integral to the debtor-creditor relationship."

Judge Silverstein also concluded that "there is statutory authority to grant third-party nonconsensual releases." This finding is in contrast to recent rulings in other districts which have found that the Bankruptcy Code does not provide statutory authority to release third party claims against non-debtors. In those cases, courts have surveyed the Bankruptcy Code and determined that the only section of the Bankruptcy Code that authorizes third party releases against non-debtors without the consent of third parties is section 524(g), but section 524(g) only applies in asbestos cases and, according to those courts, no other section provides statutory mechanism.

Disagreeing with this narrow interpretation, Judge Silverstein surmised that where a bankruptcy court is constitutionally authorized to grant such a release, the statutory authority to do so must be found in the bankruptcy court's ability "to exercise its inherent equitable power consistent with §§ 105(a), 1123(a)(5) and 1123(b)(6) of the Bankruptcy Code." Further, while agreeing that the Bankruptcy Code does not expressly authorize non-consensual releases outside of asbestos cases, Judge Silverstein observed that "neither does it prohibit them." Having then found both the constitutional and statutory authority required, the plan in *Boy Scouts* eventually joined the ranks of those gaining approval of third party non-consensual releases. Notices of appeal of Judge Silverstein's confirmation order were filed on September 21, 2022.

Conclusion

As these recent decisions suggest, the validity and authority of third party releases in US chapter 11 cases lack the uniformity and predictability many parties seek in a restructuring venue. Also of note, in July 2021, Congress took up the controversy of third party releases in the *Nondebtor Release Prohibition Act* (the "NRPA"), which would restrict a bankruptcy court's ability to approve nondebtor third party releases. If approved, the *Nondebtor Release Prohibition Act* would require the releasing party to "expressly consent in a signed writing" before a third party release would be deemed consensual, thus doing away with the ability to implement "opt-out" releases or otherwise obtain releases of claims from non-voting creditors. If a third party release or injunction does not qualify as consensual under the NRPA's strict standard, such relief would be prohibited, subject to limited, specific exceptions. Therefore, the passage of the NRPA could have significant consequences on chapter 11 filings and restructuring. Absent releases, non-debtors normally motivated to fund settlements in chapter 11 plans in order to obtain those releases may instead be incentivized to engage in prolonged litigation to limit their liability. After introduction and referral, the House Judiciary Committee voted to recommend the NPRA be considered by the full House of Representatives, while the analogous Senate version of the NPRA remains in the Senate Judiciary Committee.

Because the use of non-debtor third party releases is commonplace in certain other jurisdictions, international debtors should carefully consider their filing forum—whether in the US or in a foreign venue. Such a significant divergence in reasoning within the US could have serious implications on the ultimate success of a plan of reorganization under the Bankruptcy Code and thus will likely dictate which venue within the US debtors may use in the future to restructure their liabilities and/or whether non-US venues may receive more serious consideration as options of the restructuring.

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Momentum towards lowering Canada's criminal rate of interest?

Alexander Schmitt

On August 9, the Canadian government published a consultation paper seeking feedback on proposals to reduce the criminal rate of interest of 60 percent and make other changes in how high cost loans are provided in Canada.

Though a reduced rate has not yet been proposed, the initiation of the consultation does suggest that change may be coming. To the extent a reduction in the interest rate cap does result, it could have a significant impact for Canadian lending markets—particularly for highly distressed situations where risk profiles are high and time horizons are short.

Yet, while the stakes are high, it remains to be seen whether reforms will be broadly applied. Based on the consultation itself, the federal government appears to be concerned almost exclusively with the high-cost consumer loans, suggesting that any reforms are unlikely to affect the commercial loan market writ large.

The current regime

Under Section 347 of *Criminal Code,* it is an offence to enter into an agreement or arrangement to receive interest, or actually receive interest, at an effective rate exceeding 60% annually.

For this purpose, "interest" is defined broadly and includes all fines, fees, commissions, expenses and penalties charged or paid in connection with the underlying loan (e.g. arrangement, commitment, bonus or late fees, legal costs and expenses, etc.), subject to only limited exceptions. It also refers to the *effective* annual rate of interest and takes into account the actual timing of payments. Thus, for instance, where a loan is otherwise inoffensive but also charges substantial further fees and/or has a short term repayment term, it can breach Section 347.

Notably, the *Code* exempts consumer payday lenders from the 60 percent limit where certain conditions are met. To qualify, (a) the loan must be CAD$1,500 or less and for a maximum term of 62 days or less; (b) the lender must be provincially licensed as a payday lender; and (c) the province at issue must have certain further consumer protection rules in place and have been so designated by the federal government.

Beyond the punishments that can attach to the criminal offence itself, courts have a variety of civil remedies at their discretion where Section 347 is breached. Most typically, they will "read down" or sever the offending provisions at issue such that the agreement can be brought into compliance or require only the repayment of the principal. In particularly egregious circumstances, a court may even decline to enforce the agreement in its entirety.

Prior efforts at reform

The consultation follows on the heels of a number of recent prior attempts at reform.

When the criminal rate of interest was set in 1980, the Bank of Canada's overnight rate was 21 percent. With the Bank of Canada having maintained a near zero overnight rate for over 10 years however (and a rate below 12 percent for over 30 years), calls for reform have been growing. Since 2013, five private members' bills have been introduced that would have reduced the rate substantially and in increasingly larger amounts. The most recent of these, Bill-S-239, reached second reading in the Senate in March 2022 and would have set the rate to just 20 percent above the Bank of Canada's overnight rate.

Though none of these bills have received sufficient support from the government to pass into law, they have nevertheless had an impact—particularly as cost of living issues have become more politically salient. The federal government announced in the 2021 Budget that it would seek to fight "predatory lending practices by payday lenders" and followed it with a similar instruction to the Minister of Finance in their December 2021 public mandate letter. Finally, last month, they launched the consultation on lowering the criminal interest rate.

The consultation

The consultation generally focuses on consumer and payday lending and solicits comment across four primary issues, as follows:

- *Rates and Pricing Risk* – Whether the interest rate pricing set by high-cost alternative lenders (who, per the consultation, typically lend to consumers at the maximum allowable rate under the law) is a reflection of the actual credit risk of a borrower or whether the interest rates on these loans are set simply to comply with the ceiling permitted under the criminal rate of interest.
- *Access to Credit* – What impact lowering the criminal interest rate (including if lowered substantially) would have on the availability of credit to financially vulnerable consumers.
- *Other Loan Products* – What impact lowering the criminal interest rate would have on credit products other than high-cost installment loans.
- *Consumer Education* – How the federal government, including the Financial Consumer Agency of Canada, could improve financial education and awareness with respect to high-cost installment loans.

The Department of Finance has asked for written feedback from the public and stakeholders by October 7, 2022.

Takeaways: Exclusions (likely to) apply

Given the broad manner in which the criminal rate of interest rule currently operates (including how "interest" covers nearly all loan costs and fees), any change in the capped rate has the potential to significantly affect Canadian lending markets. This will be particularly the case for lenders in distressed situations where short time horizons, cash sweeps and additional fees and expenses can often push effective interest rates especially high.

So, should lenders anticipate a lowering of the maximum rate in the near term? It's hard to say.

The initiation of the consultation suggests that there is definite momentum towards reform. However, whether any such reform will affect a given lender is another question and is likely to depend on to whom they lend. Specifically, it appears likely that commercial lenders will be largely exempted from any reforms, while lenders to individual consumers, and above all those who are financially vulnerable, will be more directly affected.

The primary reasoning behind this opinion is based on the content of the consultation itself. The questions asked by the consultation are almost exclusively concerned with high-cost installment loans and payday lending-type products and their impact on individual consumers. The questions cover such vulnerable consumers' access to credit, the reasons for their seeking high-cost credit and how greater consumer education may help consumers avoid especially risky loan products. By contrast, the consultation almost completely ignores commercial loans to businesses, mentioning only bridge financings for real estate transactions as examples of the sort of high-interest, non-consumer loans that a reduced maximum interest rate might inadvertently affect.

Taken together, this suggests that the government's animating concern with the initiative is to protect financially vulnerable individuals rather than to interfere with lending arrangements between or to businesses.

Whether these apparent early priorities will bear out in any future amendments to Section 347 remains to be seen, but the stakes are high. Lenders would do well to monitor this issue closely going-forward.

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