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Editors' Column

Peter Gothard
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This issue sees us continuing to explore the current challenges being presented by the proliferation of cryptocurrencies and the blockchain technologies upon which they are based. Paulo Brancher provides us with an excellent article exploring the unique challenges facing regulators by these new technologies. Gilberto Gornati provides an in-depth look at how his jurisdiction – Brazil - is approaching the issues presented by cryptocurrencies in an insolvency context.

Developments in cross-border insolvency continue apace. Keeping us up to date, we have an in-depth article from Daniel Guyder and Joseph Badtke-Berkow which takes us through the debate surrounding the extraterritorial application of US Bankruptcy avoidance powers. Marvin Knapp and Daniel Arends give us a fascinating account of the establishment of COMI in the NIKI case. Caroline Moran and Nick Herrod take us through the Cayman Islands restructuring of Ocean Rig and the Hon. Leif Clark, Jack Esher and Daniel Glosband explore the emergence of mediation as a valuable tool in cross-border cases.

Our INSOL Fellows make a substantial contribution to this edition with four excellent articles.

In the first, Peter Declercq, *Fellow, INSOL International* explores how the actions of a distressed investor in the Oi group restructuring had a direct impact on the US court's deliberation of the Chapter 15 recognition application filed by another of our Fellows, Jasper Berkenbosch, *Fellow, INSOL International* who is the Dutch liquidator of the Group.

Lenny Goldberger, *Fellow, INSOL International* then takes up the running in partnership with Qing Lin to present the first in a three-part series covering the saga of Takata Corporation whose faulty airbags have led to one of the largest product recalls in history and one of the most complex global restructuring cases in recent memory. Look out for the second and third parts of this story in future editions!

The third article sees Barry Cahir, *Fellow, INSOL International* examining the use of English Schemes of Arrangement and how their benefits might be impacted by Brexit.

Sonya Van De Graaff, *Fellow, INSOL International* then teams up with Ed Downer to warn those investing in capital relief transactions with European banks of the dangers imposed by the European Bank Recovery and Resolution Directive.

Well done Fellows! It is great to see such a strong contribution to this edition.

In other articles, the Hogan Lovells pan-European team of Virginia Martinez, Clare Douglas, Romain de Menonville and Filippo Chiaves bring clarity to the complex world of set-offs in reinsurance contracts and the Morgan Lewis and Bockius team take us through the recent decision in favour of the Noteholders in the Chapter 11 of Ultra Petroleum.

We round out this issue with an excellent run-through of the new Insolvency and Bankruptcy Code in India from Rajeev Shah of RBSA Advisers. This is an incredibly important piece of legislation for India which will have an enormous impact on restructuring practice in that country.

My thanks to all contributors for such high quality and informative articles.

I hope that you all enjoy INSOL New York!

Peter Gothard, *Fellow, INSOL International*

President's Column

By Adam Harris
Bowmans
South Africa

Dear Friends and Colleagues,

"Day Zero". This was the big and scary catchphrase much publicized by our city authorities. It would have been the day upon which Cape Town's taps ran dry. Fortunately, through tight water-saving measures and an anticipation of some rain this winter, Day Zero (which was moved back several times) is now no longer imminent. But there is still no water.

Planning ahead, as INSOL always does, we thought it prudent to move out the INSOL Cape Town conference, scheduled for early 2019. This, in the interests of our members and other conference goers, given the uncertainty of the water supply. So, next year the excitement moves to Singapore, which will host the conference. The iconic Marina Bay Hotel - yes, that's the building which looks like three towers with a boat on top – will be our principal conference hotel. And the infinity pool is on top of the "boat", some 50 floors up, with limitless views of the city. It is spectacular. The conference-centre, adjacent to the hotel, has ample and versatile facilities.

Working on the theory that the rains will come, and that the crisis will be averted, the plan is for Cape Town to host INSOL 2020. It is still a wonderful destination, and it's a good call to reschedule rather than to cancel, even if it is a personal disappointment to me not to be able to host the conference in my home-town during my term as president. I know that Singapore will be a great alternative.

This second-quarter edition of IW deals with a wide range of issues. You will read about diverse topics, as far apart as crypto-currencies, mediation and schemes of arrangement. And, of course, the extra-territorial application of the US bankruptcy code. I must just pause to give credit to David L Lawton and Shannon B Wolf for the title of their just-published and interesting paper dealing with the common and distinct characteristics of the proceedings labelled "schemes of arrangement". They called it "The Thing about Schemes in the Scheme of Things". Neat.

The USA is of course very much in INSOL's sights at the moment. This is not a comment about the ebb and flow of our work in that jurisdiction! At the time that I am preparing this note, our secretariat and administrative staff are busy with final preparation in the run-up to the annual regional conference - INSOL New York 2018. The exciting educational program and the lure of New York City has attracted over 800 delegates. Apart from the conference program itself, there are ancillary programs such as the INSOL Fellows forum, the small practice issues meeting, and the dedicated offshore ancillary Meeting, ("Offshore Restructuring - Where, when and how?").

All of this collectively means that the amount of work to be undertaken is vast. Remember that INSOL does not use an events company, choosing rather the "all hands on deck" approach of running the conference and ancillary programs ourselves, which requires huge activity and input from the INSOL International staff. This, of course, does well for the (financial) bottom-line.

As another quarter races by, it remains for me to encourage you to attend the educational and ancillary programs of the New York conference, to enjoy the networking and all that the City has to offer, and to join me in thanking the INSOL team, and all the volunteers who are pulling out all the stops to deliver the exceptionally high standard, which we have all come to expect of INSOL International.

"The Insolvency and Bankruptcy Code, 2016"; a Strategic Reform to revive Distressed Assets in India

Rajeev R. Shah
RBSA Advisors
India

The Insolvency and Bankruptcy Code, 2016 ("IBC" / the "Code") came into being in India in May 2016. It has become operative since December 2016. Since its inception, the Code has evolved remarkably well. The commitment shown from all stakeholders, be it the government, the regulator or the creditors, has been very impressive. After GST, IBC is probably the most important legislative reform in the recent years, as it is expected to resolve the prevailing financial distress and the twin balance sheet problem currently being faced in India, which is also hampering investment growth.

Ecosystem under the IBC (See Figure 1 on page 7)

The IBC consolidates and amends the relevant laws relating to reorganisation and insolvency resolution in India. It strives to maximise the value of assets of distressed entities and balance the interests of all the stakeholders. Once a company has been admitted under the IBC by the national Company Law Tribunal ("NCLT"), it will be subject to a moratorium period of 180 days from the date of NCLT order (extendable up to 270 days) for determining a potential resolution including identifying new investor(s) and restructuring the current outstanding debts of the company. Failure to arrive at a resolution within the given timeframe will push the company into liquidation.

During the moratorium period, Financial Creditors will be in control of the management of the company through an appointed Insolvency Professional. An Insolvency Professional ("IP"), approved by NCLT, will take over the management of the Company and run the operations of the company during the moratorium period at the behest of the creditors.

The Code clearly defines the 'order of priority' or the waterfall mechanism in which fund flows will be distributed among the various categories of creditors. It is very significant that the government has assigned itself a position in the waterfall which is junior to most other creditors. The code also authorises the IP to inquire and investigate about past transactions and in case of any illegal diversion of assets, necessary action can be initiated through order of NCLT.

The Soul of the Code is "Resolution of the Distress". Liquidation is only an option where the resolution has failed in a time bound manner. The IP in consultation with the Committee of Creditors ("CoC") and in compliance with the requirements of the Code will lay down the key criteria for any resolution applicant to be able to submit a resolution plan. The IP will also develop a detailed Information Memorandum which will contain relevant and useful details about the subject company which can be circulated among shortlisted resolution applicants for them to be able to devise their resolution proposals. The CoC acting through the IP evaluates competitive resolution proposals during the moratorium period and approves the best one that maximises the value of assets of the distressed company.

For any resolution proposal to be approved a majority vote of at least 75% of the CoC (in terms of value) is required. The Code strives for resolution and discourages liquidation and recovery in several ways. It prevents a firm from

IN THIS ISSUE:

	page
Editors Column	3
President's Column	4
"The Insolvency and Bankruptcy Code, 2016"; a Strategic Reform to revive Distressed Assets in India	5
Focus: The Americas	**10**
U.S. Courts Divided on the Extraterritorial Application of Bankruptcy Avoiding Powers to Foreign Transfers	10
The actions of a distressed investor in the restructuring of Brazilian Telecom Group Oi SA assessed	12
INSOL World Editorial Board	14
The Takata Saga: Roadside Assistance for a Global Car Crash	15
GIPC: The Stephen Adamson Award	17
Cryptocurrencies and Brazilian insolvency law: don't be afraid of the dark.	18
Challenges in cryptocurrency regulation	20
The Emergence of Mediation in Cross-Border Cases	22
The Ocean Rig restructuring – what you need to know	24
G36 Feature	26
The Ultra Make-Whole Challenge: Enforceability of Make-Whole as an Enforceable Liquidated Damages Claim	26
The Scheme is dead, long live the Scheme!	28
INSOL Board Directors	29
NIKI's COMI – There can be only one!	30
INSOL International Group Thirty-Six	32
Insolvency set-off in the reinsurance context in different jurisdictions	33
Richard Turton Award	35
INSOL Global Insolvency Practice Course Welcomes Ninth Class	36
INSOL New York	37
Strang Founders' Award	37
Fellowship	**38**
Investors entering into capital relief transactions with European banks	38
Ian Fletcher International Insolvency Law Moot Competition	40
UNCITRAL WG III Meeting	41
Conference Diary	42
Member Associations	42

granting a preferential treatment to any particular creditor (as the waterfall for fund allocation is well defined under the Code). The Code prohibits any action to foreclose, recover or enforce any security interest during the moratorium period. In case of any creditors who are dissenting to a potential resolution proposal, such creditors will only be entitled to their portion of liquidation value of the company and not the default amount or the enterprise value of the firm (in a going concern scenario).

The Central Government is also making the right moves to facilitate the Code, for instance amendments have been made under various acts including the Income Tax Act, The Companies Act, The Banking Regulations Act; to smoothen out the resolution process. Provisions under the Income Tax were amended to allow the entity proposing a resolution plan to set off the proposed debt haircut against the carried forward losses of the company. The amendment to the Banking Regulation Act enables RBI to force banks to file their distressed accounts under IBC. The Reserve Bank of India ("RBI"), in turn, came up with an initial list of 12 companies and following up with another 28 companies, which amounts to around 50% of total distressed assets in the banking system in India.

Key Statistics on how the IBC has progressed since inception

After notification of relevant provisions of the Code, 2,434 fresh cases (including both corporates and other entities) were filed before Adjudicating Authority and 2,304 cases of winding up of companies were transferred from various high courts. Out of these, a total of 2,750 cases have been disposed of and 1,988 cases were pending as on 30 November 2017 (Source: Insolvency and Bankruptcy Board of India ("IBBI"))

As at end of December 2017, 461 corporates were undergoing the resolution process, as shown in table below. Of the 540 corporates admitted for resolution, 39 were closed on appeal or review:

Table 1: Statistics on Number of Corporates undergoing IBC process (see page 7)

The distribution of stakeholders who triggered resolution are given in table below. The number of Corporate Insolvency Resolution Process ("CIRP") triggered by Operating Creditors ("OCs") is relatively more, though the number of CIRPs initiated by Financial Creditors ("FC") has now started an uptrend, prompted by the recent amendments to the Banking Regulations Act.

Table 2: Initiation of Corporate Insolvency Resolution Process – Stakeholder Distribution (see page 7)

As at December 2017, CIRPs has resulted in 10 resolutions. The resolution plan for the revival of these 10 companies have been admitted by the Adjudicating Authority. Similarly, as of December 2017, CIRPs have resulted in 30 liquidations. In addition, 108 voluntary liquidations were also in process till the end of December 2017.

Challenges in implementing the IBC

On expected lines, the anxiety associated with the implementation of a new law will obviously pose certain challenges in the implementation of the same in its initial phases of existence. Some of the boarder issues primarily include the capability of the CoC to take timely decisions on the proposed resolution plans for the distressed entities. Since these resolution plans may involve deep haircuts for existing outstanding dues and therefore making it challenging for the creditors to act upon them. Even the IPs are treading cautiously because of a lack of precedent, as the IBC is relatively new. Further, uncertainty about the liability and consequences of their actions is also impacting performance.

In certain cases, Resolution Applicants and owners of companies that defaulted on debt repayments are complaining of arbitrary use and interpretations of the IBC by IP and lenders. Experts fear that more cases relating to non-performing assets ("NPAs") resolution may likely head to court. While the resolution process of some high profiles cases like the Binani Cement (estimated dues ~INR40 Billion), Videocon Industries, and Jaypee (estimated dues ~INR133 Billion) are in court, the next round of litigation may be expected in the bidding process of high profile cases like Bhushan Power & Steel (estimated dues ~INR485 Billion) and Essar Steel (estimated dues ~508 Billion).

Another pressing issue is the availability of the required infrastructure to implement the Code. The NCLT is the Adjudicating Authority for CIRP and the fact that the NCLT is burdened with several other corporate matters, might impact the timely implementation of the Code. As can be seen from the statistics above, there are still large number of cases which are pending for disposal.

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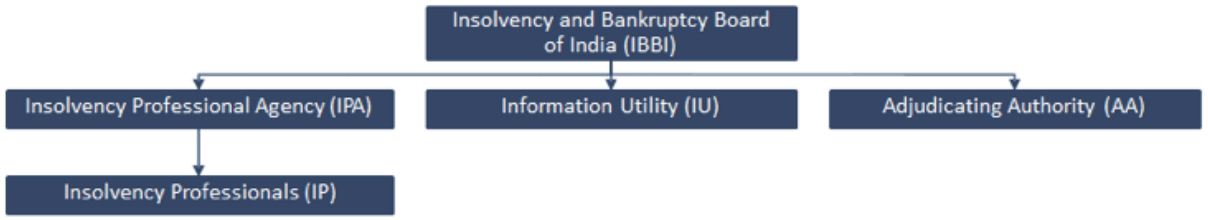
Figure 1: Ecosystem under the IBC



Insolvency and Bankruptcy Board of India (IBBI)

- IBBI is the apex body governing Insolvency and Bankruptcy Code.
- Its role is to set up the necessary infrastructure and accredit Insolvency Professionals (IPs) and Information Utilities (IUs)

Insolvency Professionals (IPs)

- IPs are professionals registered with IBBI, who would act as Interim Resolution Professional/ Resolution Professional /Liquidator/ Bankruptcy Trustee in insolvency resolution process

Information Utilities

- Information Utilities collect, store and distribute information related to the indebtedness of Companies.
- NeSL is first Information Utility under IBC, 2016.

Insolvency Professional Agency

- Insolvency Professional Agencies (IPAs) admit insolvency professionals as members amongst other responsibilities
- Currently there are three IPAs
  - Indian Institute of Insolvency Professionals of ICAI
  - ICSI Insolvency Professional Agency
  - Insolvency Professional Agency of Institute of Cost Accountants of India

Adjudicating and Appellate Authority

- Adjudicating Authority (AA) would have exclusive jurisdiction to deal with insolvency related matters. National Company Law Tribunal (NCLT) would be AA for Corporate Person and LLP firms insolvency while Debt Recovery Tribunal (DRT) would be the AA for individual or partnership insolvency respectively.
- National Company Law Appellate Tribunal (NCLAT) would be Appellate Authority for Corporate and LLP insolvency while Debt Recovery Appellate Tribunal (DRAT) would be the AA for individual or partnership insolvency respectively.

Table 1: Statistics on Number of Corporates undergoing IBC process

Quarter	No. of CIRPs at the beginning of the Quarter	Admitted	Closure By			No. of Corporates undergoing Resolution at the end of the Quarter
			Appeal/ Review	Approval of Resolution Plan	Commencement of Liquidation	
Jan- Mar, 2017	0	38	1	0	0	37
Apr-Jun, 2017	37	128	8	0	0	157
July- Sept, 2017	157	234	6	2	7	376
Oct- Dec, 2017	376	140	24	8	23	461
Total	**-**	**540**	**39**	**10**	**30**	**461**

Source: IBBI

Table 2: Initiation of Corporate Insolvency

Quarter	No. of Resolution Process Initiated by			Total
	Financial Creditor	Operational Creditor	Corporate Debtor	
Jan- Mar, 2017	9	7	22	38
Apr-Jun, 2017	32	59	37	128
July- Sept, 2017	97	102	35	234
Oct- Dec, 2017	60	66	14	140
Total	**198**	**234**	**108**	**540**

Source: IBBI

The stringent timelines under the Code for resolution process may also present challenges in the initial phases, especially when all the relevant stakeholders including the creditors, IPs, company management are yet to catch up with the renewed requirements under the Code.

Conclusion

While it may take some more time to fill in all the gaps, the IBC is by far the best insolvency law India could have enacted in the current circumstances. We are hopeful that it will be upgraded as it gains maturity and its users gain experience.

The law looks effective, but implementation challenges abound and it may take some time before it delivers the desired results. However, we feel fairly confident that the IBBI is constantly monitoring the progress of the Code and will initiate the necessary steps in order to sort out the legal and practical issues that have come to the fore.

Over time, we expect to see most of the current insecurities and challenges diminishing with increasing confidence among all stakeholders. We feel confident that IBC will play a vital role over the next few years in reviving the stressed asset scenario in India and in dealing with the twin balance sheet issues which plagues both the banks as well as the corporates in India.

U.S. Courts Divided on the Extraterritorial Application of Bankruptcy Avoiding Powers to Foreign Transfers

By: Daniel Guyder & Joseph Badtke-Berkow
Allen & Overy LLPC

Introduction

The threshold for eligibility to be a debtor under the U.S. Bankruptcy Code is generally low. A foreign entity with any property located in the U.S., even of *de minimis* value, is eligible to be a debtor. A plenary bankruptcy filing raises the spectre that the debtor or its creditors will bring litigation seeking to recover certain pre-bankruptcy transfers of property as fraudulent transfers or preferences under applicable laws. However, controversy abounds where such plaintiffs seek extraterritorial application of U.S. law to avoid wholly or primarily foreign property transfers. U.S. courts are split regarding the reach of U.S. avoidance laws to challenge such foreign transactions.

This article reviews the arguments made for and against the extraterritorial application of U.S. avoidance powers. The divide among U.S. courts on this issue is not likely to be comprehensively resolved without help from the U.S. Congress or the U.S. Supreme Court. Meanwhile, therefore, parties to transactions that occur outside the U.S. should consider the potential litigation risks and the prospect that their counterparty could become a debtor in a U.S. bankruptcy case and seek to avoid and recover foreign property transfers under U.S. law.

U.S. Avoidance Powers

Like many non-U.S. jurisdictions, property transfers made by a debtor prior to the commencement of a bankruptcy case are subject to review and potential avoidance. Specifically, section 547 of the Bankruptcy Code provides that a debtor may avoid certain property transfers that were made when the debtor was insolvent during the 90-day period (one year for transfers to insiders) preceding the bankruptcy case on account of antecedent debt that allowed the recipient to recover more than similarly situated unsecured creditors in a liquidation. Separately, section 548 of the Bankruptcy Code provides for avoidance of property transfers that were made during the two year period preceding the bankruptcy case (and potentially longer periods under applicable non-bankruptcy law made applicable under Bankruptcy Code section 544) where such transfers were made with the actual intent to hinder, delay or defraud creditors (i.e., actual fraud, regardless of financial condition) or, alternatively, where there is no such intent but the transfer was made while the debtor was insolvent and on account of which the debtor did not receive "reasonably equivalent value" (a so-called "constructive" fraudulent transfer). Bankruptcy Code section 550 also authorizes the recovery from the immediate or "mediate" transferee of the initial transferee the transferred property (or its value) that is the subject of the avoidable transfer.

Extraterritorial Application of the Avoidance Powers

There is a morass of reported U.S. cases addressing whether the U.S. avoidance powers are properly applied to foreign transactions. In the Southern District of New York (within the appellate jurisdiction of the Second Circuit Court of Appeals), at least two district decisions[1] and three bankruptcy court decisions[2] have concluded that such powers do not apply extraterritorially, while at least two other bankruptcy court decisions have held that they do.[3] This intra-district split may soon be resolved as the issue is before the Second Circuit in connection with the *Madoff Securities* litigation.[4] Outside the Second Circuit, the Court of Appeals for the Fourth Circuit (covering federal courts in Virginia and Maryland) has held that the avoidance powers apply extraterritorially.[5]

1 *Sec. Inv'r Prot, Corp. v. Bernard L. Madoff Inv. Sec LLC (In re Madoff Sec.)*, 513 B.R. 222 (S.D.N.Y. 2014) ("Madoff Decision"); *See Maxwell Comm'n. Corp. plc v. Societe Generale plc (In re Maxwell Comm'n Corp.), 186 B.R. 807 (S.D.N.Y. 1995)*. The Second Circuit declined to address the extraterritoriality issue in *Maxwell* on appeal and instead upheld the lower court's refusal to apply section 547 to the transactions at issue on "international comity" grounds. *Maxwell Comm. Corp. plc v. Societe Generale (In re Maxwell Comm. Corp. plc)*, 93 F.3d 1036, 1055 (2d Cir. 1996).

2 *LaMonica v. CEVA Group plc (In re CIL Ltd.)*, No. 14-02242, 2018 WL 329893 *24 (Bankr. S.D.N.Y. Jan. 5, 2018); *Ampal-American Israel Corp. v. Golfarb Seligman & Co. (In re Ampal-American Israel Corp.)*, 562 B.R. 601 (Bankr. S.D.N.Y. 2017); *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Bernard L. Madoff)*, No. AP 08-01789 (SMB), 2016 WL 6900689 at *6 (Bankr. S.D.N.Y. Nov. 22, 2016).

3 *Weisfelner v. Blavatnik (In re Lyondell Chem. Co.)*, 543 B.R. 127 (Bankr. S.D.N.Y. 2016); *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 480 B.R. 501 (Bankr. S.D.N.Y. 2012).

4 The Madoff Securities trustee is appealing the Madoff Decision and the Bankruptcy Court's decision on remand from the Madoff Decision.

5 *See French v. Liebmann (In re French)*, 440 F.3d 145 (4th Cir. 2006).

A recent decision by a Delaware Bankruptcy Court (in the Third Circuit) adopted the Fourth Circuit's reasoning,[6] while a California Bankruptcy Court (in the Ninth Circuit) has previously rejected it.[7]

The controversy generally starts with the "longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."[8] The U.S. Supreme Court has directed courts to engage in a two-step analysis to determine whether this "presumption against extraterritoriality" applies to prevent application of a federal statute to non-U.S. conduct. First, a court must determine whether Congress has expressed its clear intention that a statute should apply extraterritorially, thereby rebutting the presumption. Second, if no such intent can be found, the court must then determine whether a particular case involves a domestic or foreign application of the statute.[9]

Courts holding that Congress intended the avoidance powers to apply extraterritorially focus on section 541(a)(1) of the Bankruptcy Code, which defines the universe of property included in the debtor's estate that is formed upon the filing of a plenary case. Section 541 provides in relevant part that "property of the estate" includes certain enumerated property of the debtor *"wherever located and by whomever held"* (emphasis supplied), including all "interests of the debtor in property." While these courts recognize that property that is the subject of an avoidable transfer action, or the proceeds thereof, is not considered property of the bankruptcy estate until it is actually recovered pursuant to section 550, they reason that because the avoidance sections of 547 and 548 refer to the avoidance of a transfer of "an interest of the debtor in property" (thus, mirroring the language of 541(a)(1)) the extraterritorial breadth of Section 541 is impliedly incorporated into sections 547, 548 and the parallel recovery provision of section 550.

Courts declining to apply the U.S. avoidance powers with extraterritorial effect consider such reasoning as merely a strained interpretive sleight of hand that disregards the lack of express or implied congressional intent that U.S. clawback law should reach any transaction wherever located. In adopting a more circumscribed approach, these courts consider that the bankruptcy policy of marshaling the debtor's assets (wherever located) and to maximize distributions to creditors must be balanced against the strong U.S. presumption against extraterritoriality, "which serves to protect against unintended clashes between our laws and those of other nations which could result in international discord."[10]

Where the court determined that the avoidance and recovery provisions do not apply extraterritorially, the next question is whether a given transaction is foreign or domestic. Some courts consider whether the "center of gravity"[11] of a transaction is outside of the U.S., even if the transaction has some tangential connection to the U.S. Others take a more transactional approach, focusing on whether the transferee and transferor are foreign,[12] or where title was transferred.[13]

Conclusion

It is possible that the U.S. Supreme Court or the U.S. Congress will act to clarify the reach of the Bankruptcy Code to resolve the divide among lower courts. Meanwhile, however, uncertainty persists over the use of U.S. avoidable transfer laws as a basis to challenge transactions with no obvious ties to the U.S. and whether any such action would be predicated on an improper extraterritorial application of the U.S. avoidance and recovery powers.

6 *Emerald Capital Advisors Corp. v. Bayerishe Moteren Werke Aktiengesellschaft (In re FAH Liquidating Corp.)*, 572 B.R. 117 (Bankr. D. Del. 2017).

7 *Barclay v. Swiss Fin. Corp. Ltd. (In re Midland Euro Exchange Inc.)*, 347 B.R. 708 (Bankr. C.D. Cal. 2006).

8 *Morrison v. Nat. Australian Bank Ltd.*, 561 U.S. 247, 248 (2010). The disputes are not limited to extraterritorial application of U.S. avoidance laws, as there remain potential disputes regarding whether the U.S. court with jurisdiction over a foreign debtor's bankruptcy case has required in *personam* jurisdiction over a foreign defendant in any avoidance action. *See e.g., Off. Comm. Of Unsecured Creditors of Arcapita, Bank B.S.C. v. Bahrain Islamic Bank*, 549 B.R. 56 (S.D.N.Y. 2016). There may also be compelling arguments that a U.S. court should decline to exercise jurisdiction over an avoidance action based on principles of international comity. *Supra* note 1 (discussing In *re Maxwell Comm. Corp. plc*).

9 *Id.; see also RJR Nabisco, Inc. v. European Cmty.*, 136 S. Ct. 2090 (2016).

10 *In re Midland Euro Exchange Inc.*, 347 B.R. at 715 (citing *E.E.O.C. v. Arabian American Oil Co.*, 499 U.S. 244, 248 (1991).

11 See e.g., Florsheim Group Inc. v. USAsia Int'l Corp. (In re Florsheim Group Inc.), 336 B.R. 126, 130 (Bankr. N.D. Illinois 2005) (concluding that center of gravity of alleged preferential transfers was in the U.S. and therefore it was not necessary to determine whether Congress intended for the preference statute to be applied extraterritorially).

12 See e.g., Maxwell Comm'n. Corp. plc, 186 B.R. at 816.

13 Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 2016 WL 6900689 at *19.

The actions of a distressed investor in the restructuring of Brazilian Telecom Group Oi SA assessed - villain or essential contributor to the development of law & practice in cross-border restructurings/insolvencies of groups?

By: Peter J.M. Declercq
Fellow, INSOL International
Morrison & Foerster[1]

Introduction

1. On 19 April 2017 the Dutch Court of Appeal converted the Dutch suspension of payment proceeding for the Dutch finance company in the Oi group - Oi Brasil Holdings Cooperative UA ("Coop") – into a Dutch bankruptcy proceeding. INSOL International Fellow Mr Jasper Berkenbosch was appointed as Dutch liquidator of Coop (the "Dutch Liquidator"). On 7 July 2017, the Dutch Liquidator filed a petition for US Chapter 15 recognition of the Dutch Coop bankruptcy proceedings as foreign main proceedings. For the US Court to grant this recognition it would have to modify or terminate its prior decision of 22 July 2016 (the "Prior Recognition Order"). In the Prior Recognition Order the Brazilian reorganization proceedings (or "Brazilian RJ Proceedings") Coop (together with its Brazilian parent company Oi SA ("Oi"), 4 Brazilian Oi group companies and another Dutch finance company Portugal Telecom International Finance BV ("PTIF")) had commenced in Brazil on 20 June 2016 were already recognized as foreign main proceedings. To fund its Chapter 15 action, the Dutch Liquidator had borrowed $5m under a 4 July 2017 credit agreement from the so-called International Bondholders Committee ("IBC"), an ad hoc group of Coop bondholder creditors, including the distressed investor Aurelius Capital Management LP ("Aurelius").
2. In its decision of 4 December 2017 (the "Decision"), the US Court found the actions of Aurelius, to be an independent basis to decline to exercise its discretion to modify or terminate recognition under its Prior Recognition Order pursuant to the second prong of Section 1517(d) US Bankruptcy Code[2]. In the Prior Recognition Order the center of main interest (or COMI) of Coop was found to be Brazil. According to the US Court, case law (including the OAS case[3]) notes that the COMI of a special purpose vehicle (or SPV), such as Coop, turns on the location of its corporate nerve center and the expectations of creditors. The US Court found that the COMI analysis for Coop is essentially the same as it was in OAS and therefore the US Court reached the same conclusion that Brazil is the appropriate place.[4]
3. Reviewing what had happened since the Prior Recognition Order, the US Court was in particular troubled by the fact that, while Aurelius was present at the hearing that resulted in the Prior Recognition Order, Aurelius (strategically) decided to stay silent when the US Court inquired about the COMI of Coop and concluded that Coop's COMI was in Brazil, despite Aurelius being of the view that the COMI of Coop is and always has been in the Netherlands[5]. The US Court characterized the actions of Aurelius as "lack of candor before the Court" and "clearly within the realm of concerns identified in the COMI manipulation cases."[6] While the Dutch Liquidator argued that he cannot be penalized for the actions of Aurelius, the US Court took the position that it is appropriate for it to consider Aurelius' actions in its exercise of discretion under Section 1517(d) US Bankruptcy Code given Aurelius' unique and central role in creating the fact record before the Court.[7]
4. Leaving the appropriateness of the exercise of discretion by the US Court to one side, this note questions whether it can be said (as the US Court does[8]) that Aurelius' actions are at odds with many of the goals of Chapter 15 and inconsistent with the trend in international insolvency law. This note further questions whether – on balance – the actions of Aurelius have served, rather than harmed, the development of the law and best practice in cross-border restructurings/ insolvencies of groups (such as the Oi group), which is clearly still in its infancy. In this context, the US Court did acknowledge that the facts here are novel, and the result reached by the Court certainly not a traditional application of COMI manipulation principles, normally applied to a debtor with only one foreign proceeding.[9]

The so-called "double dip" strategy:

5. When for tax reasons and in order to access the global capital markets, Dutch finance companies are used in a group structure, it is not unusual for bondholders to benefit from both a principal claim against the issuer as well as a guarantee claim against the ultimate parent. The so-called "double dip" occurs when the issuer has lent the proceeds of the bond issuance to its parent and as a result has an intercompany claim against that parent. Therefore, at the level of the parent, the bondholders have a guarantee claim and the issuer

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2 The first prong of Section 1517(d) US Bankruptcy Code directs the Court to determine whether the grounds for granting recognition in the Prior Recognition Order were lacking, while the second prong examines whether the grounds of recognition have ceased to exist.
3 *In re OAS S.A.* 533 B.R. 83 (US Bankruptcy Court S.D.N.Y.), 13 July 2013.
4 Page 19 of the Decision.
5 Page 83 of the Decision.
6 Page 113 of the Decision.
7 Page 115 of the Decision.
8 Pages 116 and 117 of the Decision.
9 Page 118 of the Decision.

has an intercompany claim. The double dip for the bondholders happens at the issuer level, where they have the principal claim against the issuer and they also benefit (in addition to any payment under the guarantee by the parent) from any payment the issuer received from the parent on the intercompany claim.

6. However, in the present case, for a Coop bondholder to benefit from a dip double, it is essential that Coop effectively pursues the intercompany claim against Oi at the Oi level. Outside of a Dutch insolvency of Coop, the Coop bondholders had to rely on the Coop directors to do this. When compared to a Dutch liquidator, who would be appointed, as an officer of the court and fiduciary, in a Dutch bankruptcy of Coop, Aurelius had little faith in the Coop directors. This clearly follows from Aurelius' initial strategy, which was focused on raising concerns at the level of Coop and PTIF about the (in)solvency and directors' liability that could be incurred under Dutch law if intra-group lending continued in the zone of insolvency.[10]

The Brazilian RJ Proceedings

Legal uncertainties

7. From conversations with Brazilian restructuring lawyers, I understand that Brazilian RJ Proceedings - in short - aim to facilitate negotiations amongst stakeholders in order to achieve, within a set period of time, a restructuring plan that can be approved by the requisite threshold percentages of creditors so as to avoid the opening of Brazilian liquidation proceedings.
8. I further understand that, while it is clear in Brazilian liquidation proceedings that intercompany claims by group companies are treated as subordinate to claims of - in essence - external creditors, no such explicit rule exists in Brazilian RJ Proceedings.[11]
9. Another uncertainty under Brazilian law is whether the treatment as subordinate of an intercompany claim would still apply if the claim was pursued (on behalf of the (external) creditors of the group company) by a (foreign) court appointed liquidator of the relevant group company. A further uncertainty in this context is whether the subordination treatment would apply to a damages claim the Dutch Liquidator may have against Oi following a successful avoidance of the transactions that resulted in the intercompany claim based on *actio pauliana* under Dutch law.
10. These uncertainties all have an impact on a double dip strategy. The same applies to the threat of having a substantive consolidation (in addition to administrative consolidation) applied in the Brazilian RJ Proceedings.

Foreign recognition

11. It is further important to note that the Brazilian RJ Proceedings are not recognized in the Netherlands. Unlike the USA, which has implemented the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law") in Chapter 15 of the US Bankruptcy Code, the Netherlands have not implemented the Model Law. Neither has Brazil, which means that the Dutch Coop insolvency proceedings are not recognized in Brazil either, nor is the Dutch Liquidator.

RJ Plan negotiations

12. It must have been clear to all stakeholders that a Brazilian liquidation (instead of a successful Brazilian RJ Proceeding) would be in nobody's (economic) interest. It was further clear that, in view of the (legal) uncertainties in the Brazilian RJ Proceedings identified above, and more generally the absence of Brazilian precedents of other successfully executed cross-border restructurings of high profile complex international groups such as the Oi group, it would increase the negotiating leverage of the IBC (including Aurelius) if Coop, as a Oi group company, would be represented in these negotiations by the Dutch Liquidator, rather than the existing (Brazilian) directors of Coop. At the same time, for the creditors of Oi and the Brazilian group companies in the Brazilian RJ Proceedings (organized in the so-called Steering Committee) an increase of the negotiating leverage of ICB/Aurelius and a stronger case for a "double dip" were clearly against their interests.
13. While the US Court recognized that a creditor like Aurelius is expected to act on behalf of its own interests[12], the US Court used surprisingly strong

[10] In its initial strategy Aurelius attempted to avoid certain transactions it deemed prejudicial based on *actio pauliana* under Dutch law. See footnote 31 on page 81 of the Decision.

[11] For the opening of Brazilian RJ Proceedings by the Dutch finance companies Coop and PTIF, no input from the Coop and PTIF creditors was obtained or required under Brazilian law.

[12] Page 112 of the Decision.

language when it described Aurelius' strategy in terms of: "to undo/designed to reverse the recognition [of the Prior Recognition Order] and block the Brazilian RJ Proceeding"[13]; "undermining the Brazilian RJ Proceedings"[14]; "Aurelius seeks leverage over the Chapter 15 Debtors by attempting to block the Brazilian RJ Proceeding"; and "Aurelius has weaponized Chapter 15 to collaterally attack both the Brazilian RJ Proceeding and the Oi Group's proposed Brazilian RJ Plan."[15] The same strong language is used by the US Court when the intentions of the Dutch Liquidator are described in the following terms: "one of the goals of the Dutch Bankruptcy Proceedings [of Coop] was to block this Court's recognition of the Oi Group's Brazilian Plan", despite testimony by the Dutch Liquidator that blocking the Brazilian RJ Plan was not his goal.[16]

Assessment of Aurelius' actions

14. The trend in international insolvency law is not to promote the application of substantive consolidation in cross-border restructurings/insolvencies of groups. Typically, substantive consolidation is reserved for very exceptional circumstances only and globally its application is rare. The quite liberal approach in Brazil towards substantive consolidation is therefore inconsistent with the trend in international insolvency law. Viewed against this background, it is difficult to see why the actions of Aurelius aimed at protecting itself against the Brazilian risk of substantive consolidation should be considered inconsistent with the trend in international insolvency law.
15. In the present case, a significant reason for additional legal uncertainty is the different approach taken by the US Court to COMI under Chapter 15 in comparison to the European approach to COMI embraced by the Dutch Court in the Dutch insolvency proceedings of Coop. While Aurelius may have been instrumental in creating a situation in which this difference became apparent, it is quite something else to then also conclude that Aurelius has undermined the cooperation between the US Court and foreign courts such as the Dutch and Brazilian Courts, which each have their own different perspective.
16. Both with its initial strategy and the double dip strategy, Aurelius, like the other Oi Group creditors in both the IBC and the Steering Committee, has tried to position itself in the best way possible in the RJ Plan negotiations. That is to be expected and not at odds with any of the goals of Chapter 15.
17. More generally, distressed investors, such as Aurelius, together with their advisors, bring significant restructuring/insolvency expertise & experience to cross-border restructurings/insolvencies. They identify, test and use legal uncertainties to negotiate deals. As such, they keep all participants in a restructuring/insolvency situation honest and on their toes. While not always comfortable, as I see it, this is more a positive, than a negative.
18. In turn, actions of distressed investors (such as Aurelius) allow Courts to provide essential legal guidance and therefore reduce, instead of increase, legal uncertainties.
19. In the present case the Dutch Liquidator has his own independent role to play. The fact that Aurelius has attempted to influence his actions is again to be expected and as such not inappropriate. Mr Berkenbosch is an experienced insolvency professional, well advised, and acting as an officer of the Dutch Court. While he has received funding from the IBG, there does not seem to be (enough) evidence to justify a conclusion that he was merely an instrument used by Aurelius to execute its own strategy.

Conclusion

20. In a complex cross-border group restructuring in which significant local and international legal uncertainties exist (in part identified and tested by Aurelius), it is difficult to see why the US Court found it necessary to hold the actions of Aurelius to be an independent basis to deny the Chapter 15 recognition petition of the Dutch Liquidator. I don't think the US Court should allow the actions of a single Coop creditor to – in effect – weaken the position of the Dutch Liquidator, who acts on behalf of all Coop creditors. In addition, I do believe that the actions of Aurelius have contributed to the necessary further development of law and (best) practice in the area of cross-border restructuring/insolvency of groups and therefore – on balance – may have done more good, than bad.

[13] Pages 104 and 113 of the Decision.
[14] Page 106 pf the Decision.
[15] Page 116 of the Decision.
[16] Pages 109 and 110 of the Decision.

The Takata Saga: Roadside Assistance for a Global Car Crash

(Part 1 of 3)

By Leonard P. Goldberger,
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This is the story of Takata Corporation and its affiliates ("Takata"), and how an explosion of one of its automotive airbags in Switzerland eventually led to its extraordinarily complex, multi-billion dollar, global restructuring in a United States bankruptcy court.

This Part I of the article will describe how this massive global product liability crisis precipitated the insolvency of Takata, one of the world's leading automotive safety parts suppliers.[2] Part II will report on how its successful U.S. bankruptcy case became the focal point of its global restructuring. And Part III will recount some of the lessons learned, and how they are likely to resonate throughout cross-border insolvency practice.

Exploding Airbags

Takata was one of the leading global companies – indeed, a pioneer – in the automotive safety parts industry. It enjoyed long-standing business relationships with many of its customers; and it had more than 50 manufacturing plants in over 20 countries on 5 continents. During the year preceding its bankruptcy, the Takata debtors had annual sales of about $2 billion. At the time it filed its U.S. bankruptcy case, Takata owned about $1.7 billion in assets.

Although the global automotive manufacturing supply chain is complex, many automakers source components from only a handful of large suppliers. Takata was one of them. As it turned out, the concentration of its airbag components among those global automotive manufacturers with significant market shares only magnified its problems.

The product that caused Takata's downfall was its PSAN Inflator, a component of an airbag that inflates it upon a collision. Takata's airbags were installed in an estimated 60 to 70 million cars manufactured worldwide by leading automakers, including, BMW, Daimler, Fiat Chrysler, Ford, General Motors, Honda, Jaguar Land Rover, Mazda, Mitsubishi, Nissan, Subaru, Toyota, Volkswagen, and AB Volvo. The problem was that certain PSAN Inflators ruptured upon deployment of the airbag, causing serious injuries and, in some cases, deaths.

The first incident of a rupturing airbag inflator occurred in 2003 in Switzerland. Many more such incidents involving Takata airbags occurred during the following years. This eventually led to massive recalls by the automakers, and resulted enormous ($ billions) and expansive claims back against Takata.

Global Ripple Effects

As the scope and scale of the problem unfolded, the collateral damage rippled through the global automotive industry. Massive recalls of cars with Takata airbags inflicted substantial financial and reputational damage upon those automotive manufacturers using Takata's products, as well as their insurers, and ultimately the whole automotive parts industry.

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[2] The factual information for Part I of the article was taken directly from the "Disclosure Statement for Joint Plan of Reorganization of TK Holdings, Inc. and its Affiliated Debtors" filed in Takata's U.S. bankruptcy case, *In re TK Holdings, Inc., et al.*, pending in the United States Bankruptcy Court for the District of Delaware, at Case No. 17-11375-BLS (Jointly Administered). [Doc. 1164].

In 2014, the U.S. National Highway Traffic Safety Administration ("NHSTA") commenced a formal investigation because of the growing number of complaints about rupturing Takata airbags. That investigation eventually led to a recall of about 3 million cars containing defective Takata airbags – the largest automotive recall campaign in U.S. history.

These recalls by Takata's automaker customers triggered billions of dollars of estimated reimbursement claims from those manufacturers back against Takata, based on contractual indemnifications and contribution in connection with administering the recalls and installing replacement parts.

NHTSA also imposed against Takata a non-contingent, $70 million civil penalty. In addition, it imposed other non-monetary sanctions, including, the obligation to preserve recalled airbag inflators and other relevant product data and evidence. It also ordered the phase-out of Takata's manufacture of certain PSAN Inflators by the end of 2018, and imposed a contingent, $130 million civil penalty in the event that Takata failed to comply.

Then there were lawsuits. About 100 personal injury and wrongful death lawsuits relating to defective airbag inflators were filed against Takata in courts throughout the U.S. Most of these suits also alleged joint and several liability against Takata's automaker customers, thus triggering billions of dollars in indemnification and contribution claims based on their supply agreements with Takata and under common law.

In addition, there were approximately 200 personal injury and wrongful death claims asserted against Takata that had not yet resulted in lawsuits. Takata also expected to receive a substantial, although presently-unasserted, claims in connection with the expansive recall campaigns for vehicles with Takata airbags that remained on the road. Moreover, about 80 separate consumer class action lawsuits were filed against Takata and certain of its automaker customers in U.S. courts alleging economic losses covering approximately 50 million consumers that purchased or leased vehicles with defective PSAN Inflators.[3] Similar consumer class action lawsuits were also brought in Canada and Mexico. In addition, antitrust class action lawsuits (unrelated to the malfunctioning PSAN Inflators) were filed against Takata in the U.S. and Canada.

The private civil litigation was mirrored by various governmental enforcement actions. Various U.S. states (acting through their attorneys general) commenced investigations and filed consumer protection actions. These actions sought combinations of relief, including, civil penalties, administrative fines, restitution for consumers, disgorgement of profits, and injunctive relief.

Most significantly, the U.S. Department of Justice commenced a criminal wire fraud investigation. After 2 years, Takata settled this investigation by entering a guilty plea, and by agreeing to a restitution order imposing a $25 million criminal penalty, requiring an $850 million restitution payment to its automaker customers, and a $125 million restitution payment to compensate individuals who had suffered (or will suffer) personal injuries caused by Takata's malfunctioning airbag inflators.

An Impossible Sale

In the face of this tsunami of liability, the only realistic way for Takata to satisfy its creditors' claims was to monetize its global assets through a sale. The barriers to finding potential buyers, in the face of its staggering monetary liabilities and governmental-imposed sanctions, were overwhelming.

To do so would have required a series of transactions that simultaneously effected several distinct (and, in some cases, mutually-inconsistent) features. To begin with, Takata's global non-PSAN Inflator assets had to be sold for an amount sufficient to satisfy its creditors' claims. It was unlikely that any buyer would pay even close to a fair market, going concern value unless it could be shielded from the enforcement of the existing – as well as future – monetary claims asserted in ongoing litigation, as well as the other continuing obligations from the governmental enforcement actions.

Next, Takata had to continue to effectively operate its PSAN Inflator business – at least long enough to ensure compliance with its obligations under the NHSTA settlement, as well as its ongoing recall-related and product supply obligations to its automaker customers and the public. Both the governmental enforcement agencies and Takata's automaker customers recognized, however, the importance of having Takata preserve its PSAN Inflator operations for the duration of the recalls; and the need for a global coordinated strategy for dealing with the ongoing litigation in which they were still involved.

Finally, all of this had to be accomplished within the tight time deadlines – and subject to the various other conditions imposed by the NHSTA settlement and the Department of Justice restitution order. Failure to timely satisfy these obligations would have subjected Takata to substantial contingent monetary penalties and other sanctions. And, of course, all of this had to be accomplished in the face of the ongoing litigation raging in multiple courts around the world.

Considering the extraordinary complexity of effectuating a global transaction – while simultaneously managing multiple adverse parties with competing claims and interests – a privately-negotiated sale of Takata's global assets was all but impossible. As such, Takata and certain of its constituencies settled on filing a case under Chapter 11 of the U.S. Bankruptcy Code to serve as the focal point of the global reorganization. This, they concluded, was the only way to effectuate a transaction of this scale and complexity in such a relatively short period of time.

All of this will be discussed in Part II of this article. To be continued.

[3] Courts have already approved settlements among certain consumer classes and four of the automotive manufacturers for about $1.256 billion.

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In association with Redress Solutions PLC

We are delighted to announce the creation of this new award which will be presented for the first-time for the 2017/2018 GIPC First in Class in Singapore in 2019 at the Fellows Award Ceremony.

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He also devoted time to the development of the profession, and was President of INSOL International from 1993 to 1995. Many will remember him as Chairman of the organising committee for the successful INSOL International Quadrennial Congress in London in 2001, Chair of the INSOL International Nominating Committee, a member of the Turton Award Panel, and leader of one of INSOL's Taskforces.

His work with INSOL was just a part of the impact Stephen made in the world of cross-border practice. He was known and respected throughout the world whether in Dubai, Bangkok, Tokyo or New York. Indeed, such was his reputation, that he was awarded a CBE for services to the insolvency profession in 1999.

Redress Solutions PLC is proud to honour the memory of Stephen through the GIPC where the future leaders of the profession he so loved are making their way in the turnaround and insolvency profession.

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Cryptocurrencies and Brazilian insolvency law: don't be afraid of the dark.

Gilberto Gornati
Sao Paulo

"Is the moon there when nobody looks?"

(MERMIM, David. Is the moon there when nobody looks? Reality and the quantum theory. (in) Physics Today, volume 38, issue 4, April 1985.)

German physicist Ernst Pascual Jordan stated that Albert Einstein once described one of his critics on quantum physics by saying that he *"(...) really believed that the moon exists only when [he] look[s] at it."*[1] Summarizing the physics discussion on quantum theory (and going as deep as a saucer can be), it means that in an atomic level, the existence of such natural satellite would depend on its observer. Such statement – as well as the whole bunch of physics theories to the ordinary layman – may lead one to avoid deeper discussions on such matters and become fearful about the steps that those discussions may reach.

The problems raised by lawmakers, lawyers, judges, justices and everybody professionally connected with legal subjects related to cryptocurrencies touch similar bases of fear and insecurity as those faced by other complex situations along with the development of humanity throughout the centuries.

If one starts to think about how ordinary national currencies achieve their value currently, that is based mainly on trust and reliance on each countries central bank. The "what if" questions should lead to the understanding of how fragile currency systems are. Such perception, aligned to the development of electronic/digital technologies, brings us to the current discussion on blockchain technology and cryptocurrencies created from this system.

Unfortunately, state of the art of blockchain developments are not well understood, nor are the potential impact on the people's lives. This lack of knowledge creates fear relating to the use and development of the technology. On a general level, ignorance, in its pure sense, causes fear and leads to rejection - the new kid on the block will be certainly be the target of others: this is the situation currently observed in Brazil regarding cryptocurrency matters.

On the other hand, Brazil is also facing a deep economic crisis which has led a lot of companies to file for insolvency procedures before the Brazilian courts. Apart from bankruptcy *(falência)* procedures, judicial reorganizations *(recuperação judicial)* and out-of-court reorganizations (such as the recuperação extrajudicial) have also been filed in considerable volume compared to other periods since the existence of Law #11.101/2005 (Brazilian Insolvency Law).

Overlaying blockchain and cryptocurrency issues on the economic crisis and insolvency laws has led to questions – which are not easy to face and to discuss.

For the purposes of this article I will set such questions under a two-fold perspective:

1. The first perspective will consider the fact that cryptocurrencies are traded mainly through exchange companies. What happens if an exchange company starts an insolvency procedure? How should we treat the cryptocurrency credits held by its clients? Which assets are property of the exchange company from Brazilian Insolvency Law perspective?

2. The second perspective will discuss the problem of the lack of a legal framework or definition of cryptocurrencies. Do we treat cryptocurrencies as currencies, as shares, as intangible assets, or, as contracts (similar to commodities and options contracts) Which legal definition best defines such a new thing?

Both matters, under Brazilian insolvency law are in fact connected to the same issue: the crisis of the economic agent and its outstanding credits due by the debtor to its creditors.

Looking at the first perspective from a Brazilian insolvency law perspective, the exchange company which is the provider of the trading platform shall never be considered the owner of the cryptocurrency wallets, which means that if any cryptocurrency disappears from its system, the investor is the owner and is also the creditor and in such case the exchange company should be considered only a holder of such assets (which are in fact from

[1] MERMIM, David. Is the moon there when nobody looks? Reality and the quantum theory. (in) Physics Today, volume 38, issue 4, April 1985, page 38.

third parties – the clients of the platform). Moreover, the exchange company would be considered a custodian *(fiel depositário)* of the cryptocurrencies, which brings liabilities to such company under Brazilian law, mainly regarding Brazilian Civil Law *(Código Civil)*. The owner is still the investor as the cryptocurrency is its property. If those electronic documents disappear, the holder shall bear all the costs and expenses, due to the risk of its own activity. The exchange company may however, be subject to criminal investigations under Brazilian Insolvency Law. It is worth mentioning that such matters are not related to the risk of the investment but are related to the custody by exchange companies of the electronic/digital documents that reflects each of the cryptocurrencies. Disputes arising from the bankruptcy of exchange companies should be determined by reference to Brazilian Civil Law, especially as regards the analysis of the liabilities of the exchange company as custodian of the documents and, based on Brazilian Insolvency Law, in order to determine if the investor is the owner and the company exchange is only the custodian or if there is any other agreement among parties that may bring the exchange company under Brazilian Criminal Law.

Depending on the conclusion, the ruling of the case will define an indemnification obligation, a fine, or the obligation to return the cryptocurrency to owner.

The second perspective case is different in that it discusses the legal nature of cryptocurrencies before Brazilian Law. We still don't have the answer at the time of writing, mainly because the legal definition is something artificially established by the Brazilian legislator. The legal nature of cryptocurrencies will be defined once the legislator decides on this matter. If it is a currency, then the Brazilian Central Bank should be the one responsible to rule on this matter, on the other hand, if it is considered as securities or shares, Securities and Exchange Commission *(Comissão de Valores Mobiliários)* should be entitled to rule on statues and other normative procedures on this matter. Until this determination is made, Brazilian Law has no definitive position on the nature of cryptocurrencies.

Determination of this second perspective is a critical matter under Brazilian Insolvency Law as the law sets out different types of treatment for each type of credit in insolvency procedures. For example: shares of a debtor company shall not vote under a General Creditors Meeting in a judicial reorganization proceeding *(Recuperação judicial)*, and in case of bankruptcy such credits that reflects the equity of the company will not be paid back to shareholders. Unsecured credits will be part of other credits to vote for a judicial reorganization plan *(plano de recuperação judicial)* but will have no special treatment unless a collateral raises such credit to a different treatment, such as fiduciary liens – which have different treatment and should not be entailed to the insolvency procedure.

The main problem in those cases is related to the legal insecurity and the increase of transaction costs. Legal insecurity on this matter is harmful to the economy, to the court ruling and to contracts and may have the opposite result to Brazilian Law and Brazilian economy. Investors and entrepreneurs will be discouraged from developing the market for cryptocurrencies and their related blockchain technologies. Brazilians will still live the same problem that is still affecting the development of the country - continuously importing foreign technologies and investing in foreign companies and foreign cryptocurrencies to the detriment of the development of technologies that would fit better to Brazilian reality.

But all questions on these matters depend on the work of lawmakers and the willingness of the Brazilian legislators. Only after such definitions are established, the legal system will be able to define how cryptocurrencies will fit before Brazilian Insolvency Law.

To summarize, Brazilian Insolvency Law is ready to face the issues raised in the first perspective case – an insolvency procedure of exchange providers, but the law is not even close to solving the problems that may rise on the second situation - the legal nature of cryptocurrencies. From both creditor and debtor perspective it may be considered as a document of credit, but its legal nature means that it may receive different treatment depending on the legal framework that may apply.

It will take a more defined legal framework, statues and legislative propositions to create an effective protection and definition of the credits and interests raised by the advent of cryptocurrencies.

Notwithstanding the current shortcomings of the legal framework, legal practitioners shall analyze the documents related to the issuance and acquisition of each type of cryptocurrency and will need to fit the business operations under existing legal definitions. After all, Law is considered a rhetoric science and most of the time disputes before Brazilian courts are ruled based on legal principles and legal theory – mainly contracts, commercial obligations and dispute resolution. Based on that, legal practitioners may find efficient legal tools to solve the disputes that will inevitably arise from the crossover of insolvency law and commercial cryptocurrency operations.

New problems create the need for new solutions but the fact is that the current legal framework is not currently ready to provide solutions on a timely basis. Having to wait for better legal definition creates uncertainty and insecurity which are likely to generate additional problems in this area.

Challenges in cryptocurrency regulation

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Cryptocurrencies have now become part of our economic reality. The decentralization of the validation of transactions and the absence of a single agent responsible for a cryptocurrency's issuance impose regulatory challenges and risks to anyone interested in acquiring them as a store of value or for the purchase and sale of goods and services. Because of the basic characteristics of cryptocurrencies, it is not possible to frame them in the legal concepts and qualifications typical of the real economy. As a consequence, any envisioned regulation should be focused not only in the fighting illicit acts financed through these assets, but also in providing acquirers and users access to clear and straightforward information on the risks involved.

Before we know what makes sense to regulate, it is important to ask if we can effectively find a subject to be regulated. The regulation of fiduciary money is made by the State itself, its issuer. But the regulation of cryptocurrencies finds a natural obstacle: there is no central issuing authority. Given its open platform features, the system is made available to any user who wants to be part of it, thus having free access and usage. Therefore, any attempt to prevent its issuance or to establish rules related to the system's operation is not feasible. As a result, any State seeking to regulate cryptocurrencies must assume its inability to shape it to other existing regulation.

The regulation of cryptocurrencies could, at least in theory, be focused in two actors:

(a) the acquirer/user of the cryptocurrency, with possible limitations to transactions or their custody; or

(b) the intermediary of the purchase and sale ("the exchange"), whose purpose is to enable the transfer of cryptocurrencies, or their exchange into a fiduciary currency.

Among the options available, perhaps the most effective is to regulate the activity of exchanges. They are created by the market and not by state authorities and, rather than being mere buying and seller agents, they add value to the financial markets. The development of such markets depends on the creation of such new financial intermediaries, whether to exchange coins currencies, to act as cryptocurrency portfolio service providers, or even as clearing houses for transactions involving such assets. For example, countries that wished to ban the trading of cryptocurrencies from their territories did so, basically, by imposing severe restrictions on exchange activities in their territories. This was done, for example, by Bangladesh, India, Russia, among others, even though the effectiveness of such ban is questionable.

Governmental concerns include possible tax evasion and use of cryptocurrencies to avoid the traceability of payments made in electronic transactions and the fact that the valuation of assets is unaccompanied by the respective taxation for capital gain. Tax treatment of cryptocurrency as an asset accentuates its legal nature as property primarily used as a reserve of value over its qualification as a means of payment. With this path adopted by the State, someone who intends to use the cryptocurrencies frequently to buy and sell products and services must carry out a highly sophisticated control to record all transactions, as well as the respective capital gains in each situation, paying the tax regularly to keep up with legal obligations. We know, however, how unworkable this providence would be in practice.

Another regulatory concern relates the use of cryptocurrencies to finance or even allow the purchase and sale of illicit products and services, including drugs, weapons, pedophilia, among other examples. The prohibition of this type of transaction is the most obvious measure to be taken by any government, which is independent of specific regulation involving cryptocurrencies. Any prohibitive rule is ineffective, however, if it does not identify and punish in the real world, those responsible for illegal activities committed in the virtual world.

One measure that may aid in the tracking and surveillance of illicit transactions is the encouragement of personal identification in transactions involving cryptocurrencies. The mechanism for this could be built into the taxing of transactions involving cryptocurrencies as it is sometimes done, for example, in transactions involving stocks and securities above a certain value.

Another idea would be the aggravation of criminal

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penalties if the illicit act is committed by using cryptocurrencies as a deterrent.

In relation to the protection of individuals who wish to enter into this universe of transactions, the volatility of price and the lack of knowledge of the technological characteristics of cryptocurrencies justify some minimum measures aiming at clarifying the way the currency works and the risks involved.

Cryptocurrencies do not have a central issuing and control authority, do not have official clearing houses, aren't supervised by financial institutions and have users who act autonomously in transactions. Because cryptocurrency exchanges are not entities that fit the typical concepts of securities distributors, exchange houses for fiat currency, or regulated financial institutions, it is important to qualify the role that these intermediaries play in the economy and establish minimum rules for their operations. Apart from informing users regarding the risks in the acquisition and use of cryptocurrencies, measures such as minimum capital, liquidity index or other such rules that could show to any third party if a certain exchange structure is consistent with the activity performed are all advisable.

A minimum measure of protection for cryptocurrency buyers would be to establish the obligation of the exchanges to inform users of:

(a) the nature of the virtual currency;

(b) identification of the exchange and, to the extent possible, who is selling and buying the currency;

(c) the transaction costs involved, including brokerage and arbitrage;

(d) the risk of wide and unexpected fluctuations in the currency's price and exchange rate;

(e) the risk of the transaction being defrauded; and

(f) that the loss of access passwords implies the definitive loss of assets.

Unlike extensive and sometimes prolix regulatory frameworks, the opportunity to regulate cryptocurrencies would reside in the simplicity of rules and mechanisms of control, especially on cryptocurrency exchanges, which are currently few. We will only know with hindsight whether cryptocurrencies are economic bubbles but it is clearly beneficial to take steps to minimize potential damage as long as such coins are in use and relevant to society.

The Emergence of Mediation in Cross-Border Cases

By
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In May of 2017, the authors of this article, principals of the cross-border mediation and consulting firm CBInsolvency LLC (CBI), worked on a presentation for the R3-Insol Europe Joint International Restructuring Conference in London. It was called "The Emergence of Mediation in Cross-Border Cases", a title we liked so much we have gratefully used it for this article.[1] While it is now common in U.S. bankruptcy cases to use mediation to resolve disputes, elsewhere the implementation of mediation in insolvency cases has been slow to develop for a number of reasons - local culture and antiquated insolvency regimes being primary.[2] However, courts, legislatures and practitioners are increasingly interested in innovative strategies in dispute resolution that conserve judicial resources by generating case resolutions at less cost and in less time, while minimizing the risk of lengthy appeals.

Cross-border cases, with the unique problems of multiple jurisdictions and the possibility of conflicting laws and/or rulings, are inherently good candidates for mediation. Recognizing this, the European Union Insolvency Regulation (2015/848, recast), much of which went into effect on June 26, 2017, suggests mediation for the resolution of the insolvency cases of groups of related companies in different countries, such as parent and subsidiaries or affiliates, by an appointed "coordinator" who could mediate toward a global restructuring among the "insolvency practitioners" in charge of the various proceedings in each country.[3] In a related development, judges are implementing procedures such as the Judicial Insolvency Network ("JIN") Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters to more effectively manage multi-jurisdictional disputes in cross-border cases, for increased cooperation among courts.[4]

Strategies for Using Mediation in Cross-Border Cases

A definitional moment at the outset is appropriate, as "cross-border case" is a broad term having different meanings depending on context. A cross-border case can involve proceedings of members of a corporate group in different countries, or a main proceeding of a single entity in one jurisdiction with an ancillary proceeding, such as a Chapter 15 case in the U.S., in another.[5] For purposes of considering how mediation can best be used in cross-border cases, our definition of cross-border is any case in which the parties are from two or more different countries, whether or not insolvency proceedings in multiple jurisdictions may be involved.

Mediation could be pre-mature in cross-border cases until threshold issues such as jurisdiction, elig-ibility, COMI and the like have been resolved so that the underlying dispute is justiciable and the parties are ready to negotiate. But even those threshold issues could be mediated. In the example of the *APR Energy* eligibility case cited above, the underlying dispute involved whether a creditor's lien was perfected. The foreign court had ruled it was not, and the Chapter 15 was filed for the purpose of enforcing this result in the U.S. Bankruptcy Court and halting redundant litigation. However, at the time of the writing of this article, recognition had been denied and the Chapter 15 case had been dismissed by the Bankruptcy Court. While the Bankruptcy Court decision was affirmed in part by the District Court, it was remanded on grounds that will likely result in recognition of the foreign proceeding and the equivalent of reversal. In that case, the underlying dispute could have been mediated at any point but mediation would more likely be availing if recognition is granted and litigation outside the Bankruptcy Court is stayed. It is at that point that the leverage of law and relative strength of position between the foreign representative and the creditor would provide an adequate base from which negotiations and mediation could be pursued.

So at the point that mediation can realistically be considered, how is it best implemented in a case? It is

1 CBI principals were accompanied by Panelists Fred Hodara (ret.) and Abid Qureshi of Akin Gump (New York), and Kevin Lloyd from Debevoise & Plimpton (London), to whom we owe our thanks for the good thoughts that came out of this Panel, some of which are reflected in this article.

2 *See* Jacob A. Esher, *Insolvency Mediation Around the Globe*, Global Restructuring Review (January, 2018), viewable by subscription at https://globalrestructuringreview.com/article/1152900/insolvency-mediation-around-the-globe (non-subscribers may request a courtesy copy from the authors).

3 Official Journal of the European Union, L 141, Vol. 58 at 19, 35 (June 5, 2015).

4 See Jack Barton, *SDNY and Bermuda Adopt JIN Guidelines on Court Cooperation* (Global Restructuring Review, March 2017).

5 The case of *Jones v. APR Energy Holdings Ltd. (In re Forge Group Power Pty Ltd.)*, 17-2045 (N.D. Cal. Feb. 12, 2018) is a recent example of this, and dealt (erroneously, in our opinion) with the continuing controversy of whether Section 109 of the Bankruptcy Code is applicable to determine eligibility of a Chapter 15 case. *See* Daniel M. Glosband and Jay Lawrence Westbrook, *Chapter 15 Recognition in the United States: Is a Debtor "Presence" Required?*, 24 Int'l Insolv. Rev. 28 (2015) (available at Wiley Online Library (wileyonlinelibrary.com)); summarized in Harvard Bankruptcy Roundtable, http://blogs.law.harvard.edu/bankruptcyroundtable/?s=glosband.); Glosband and Westbrook, *Opinion: No Debtor "Presence" is Required for Chapter 15 Recognition,* American Bankruptcy Institute Journal, May 24, 2015.

difficult to find sources of information to determine how mediation is used in cross-border cases, primarily due to the fact that mediation is inherently private and cases resolved through it do not usually result in reported decisions. Even when they do, the mediation itself is confidential. One recent reported decision from Australia, however, illuminates what we have experienced as an effective strategy for using mediation, and we thank Prof. Dr. Bob Wessels for bringing this to our attention.[6] The case, In re Boart Longyear Limited, involved two interdependent schemes of arrangement which had been proposed to the Australian Supreme Court in New South Wales, an unsecured creditor scheme and a secured creditor scheme. Creditor objections had been raised in the proceedings, so the parties had the benefit of the issues being framed with court oversight. At this point, presiding Judge Black cannily observed that mediation could resolve the objections, clearing the way for him to approve the schemes. Consequently, he ordered the parties to engage in mediation. The mediation was successful and the schemes were approved.

This strategy - to leverage the mediation at an appropriate time in court proceedings - is very effective, and we have mediated cases in which it has been used.[7] Often, the court will provide some useful thoughts for the parties to consider, which can help toward consensual resolution of the issues. In a large case which involves many disputed claims, obtaining a ruling on an important threshold issue common to the claims, such as on a motion to dismiss, can be singularly helpful in obtaining consensual resolutions of the other similarly-situated claims. Mediation of these claims prior to any court involvement is often premature and is less likely to be successful.

Of course, this is a generality and mediation can be just as successful when there have been no prior court proceedings involving the parties. One of the benefits of mediation is that it creates a forum where parties and their counsel have an opportunity to assess a dispute sooner than would be required in formal courtproceedings. Mediating a dispute before positions have become further polarized and before substantial resources have been invested in seeking a court determination can be very productive. Even in cases where a cross-border filing might be exposed to a dismissal attempt, if the parties are prepared to negotiate the underlying dispute, using mediation and avoiding the costs and delay of a jurisdictional fight can be preferable to a proceeding on the merits with an unpredictable result. It is a matter of appropriate risk assessment, which is usually the foundation of the work involved in commercial mediation. If the mediation does not result in a meeting of the minds within an acceptable range of risk, little is lost as the process is not binding and the parties can always resume the courtroom activities.

Translation and Cultural Challenges in Cross-Border Cases

A discussion of mediation in cross-border cases would be remiss if it did not include process-driven issues, particularly language and culture. In our experience, mediations most often can be conducted in English, which is the world's commercial language in many respects. However, this is not always true, and translation services are sometimes needed. While differing languages can be solved through translation, it is commonly said that a large part of communication is non-verbal – things such as tone of voice, cultural mannerisms, idiomatic expressions and the like can pose significant communication challenges in cross-border cases even with translation services. A hired translator is often not equipped to interpret these nuances to the mediator, much less the opposing party, effectively.

In such situations, we have suggested that the party engage a local counsel or have counsel who is able to provide the nuanced interpretation on their team. We then utilize the caucus, or separate meetings, with that team to ensure that we are getting the full breadth of the party's communication. It is often not possible to do this in a joint session, which heightens the formality and positioning between parties. Indeed, a hallmark of the mediation process is that it allows the mediator to serve as a buffer against the contentious positioning and argument that can often derail negotiation. The mediator is able to communicate the specific considerations and nuanced responses of the opposing party in a far more productive way using this approach.

Sometimes, having a familiarity with the legal and cultural milieu of parties can greatly enhance the mediation process, because it enables the mediator to empathize more readily, and so build trust. We have experienced this first hand in a number of mediations involving parties from Europe, China, and the Middle East. Understanding variations in practice and procedure similarly enhances the mediator's ability to assist parties in the cross-border context, as mediators need to be able to appreciate how those differences affect the relative negotiating positions of the parties.

Conclusion

We have observed a continuing trend toward a more party-autonomous dispute resolution culture, providing for parties' retention of greater control and decisional authority in cases. The International Bar Association's Mediation Committee has referred to this as "Consensual Dispute Resolution", or "CDR".[8] The emergence of mediation in cross-border cases is yet another aspect of this evolving approach to resolving insolvency cases with better results for debtors, creditors, and local economies.

6 *See In the matter of Boart Longyear Limited* (No 2) [2017] NSWSC 1105, viewable at www.caselaw.nsw.gov.au/decision/599a8cf0e4b058596cba97cd, as reported by Prof. Dr. Bob Wessels in his blog, http://bobwessels.nl/blog/2018-01-doc8-mediation-in-corporate-restructuring-proceedings/?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+bobwessels+%28Prof.+Dr.+Bob+Wessels%29 (viewed on Feb. 15, 2018).

7 The strategy was particularly effective in *In re Lehman Bros. Holdings Inc.*, No. 08-13555 (SCC) (Bankr. S.D.N.Y.), in which CBI principals served as mediators. *See Id.*, Letter to The Honorable Shelley C. Chapman Regarding Eighty-Second ADR Status Report (2/23/2017, Docket No. 54893).

8 BA Mediation Committee Newsletter, June 2015.

The Ocean Rig restructuring – what you need to know

By Caroline Moran and Nick Herrod
Maples and Calder
Cayman Islands

Much has been written about the Ocean Rig restructuring but just what makes this deal the one that has put the Cayman Islands on the restructuring map?

Prior to the various panel sessions that are scheduled to discuss this case at INSOL New York, Caroline Moran and Nick Herrod of Maples and Calder set out the headline points so that INSOL delegates can get the most out of the sessions.

Background

The hotly contested restructuring was implemented through four complex inter-linked Cayman Islands schemes of arrangement. This resulted in the compromise of US$3.7 billion of New York law governed debt for the Cayman Islands registered parent of the Ocean Rig group (UDW) and three of its wholly owned Marshall Islands incorporated subsidiaries (DRH, DFH and DOV). The debt was largely swapped for equity in UDW. It is one of the largest restructurings implemented by way of schemes of arrangement and the largest ever Cayman Islands restructuring.

The terms of the restructuring were finalised and the schemes of arrangement were implemented with the protection of a Cayman Islands restructuring provisional liquidation – this process took just under six months.

Breaking new ground in the Cayman Islands

Jurisdiction

- The Cayman Islands Court confirmed its jurisdiction to scheme foreign incorporated companies – considerably widening the circumstances in which Cayman Islands schemes will be available. The Marshall Islands incorporated subsidiaries were registered as foreign companies in the Cayman Islands – this created the jurisdictional hook for the schemes. The COMI shift (see below) meant that the Cayman Islands court was satisfied that it was appropriate to exercise its jurisdiction over the Marshall Islands incorporated companies.
- Following the US and England, the Cayman Islands court held that forum shopping for a restructuring jurisdiction is not abusive where it is carried out for the best possible outcome for creditors (as was the case in Ocean Rig). The Cayman Islands can therefore be actively selected as the jurisdiction within which to implement a restructuring in the right circumstances.

Restructuring provisional liquidation

- There is no standalone restructuring regime in the Cayman Islands such as administration or Chapter 11. Instead restructuring provisional liquidators can be appointed in order to obtain a moratorium and the provisional liquidators will then carry out a restructuring either using a Cayman Islands scheme or a foreign restructuring process.
- The Ocean Rig case demonstrates the defensive advantage of using restructuring provisional liquidators including:
  - Obtaining an automatic moratorium on creditor action in the Cayman Islands (no stay on the enforcement of security).
  - The ability to obtain a temporary restraining order in the US pending recognition under Chapter 15 of the US Bankruptcy Code.
  - The flexible nature of the regime – the powers of restructuring provisional liquidators are tailored to meet the requirements of the case.
  - Providing an independent voice to negotiate with dissenters (the Ocean Rig provisional liquidators assisted DRH to strike a deal with one group of creditors who could otherwise have vetoed the DRH scheme).
  - Providing independent scrutiny of the schemes. As officers of the court the provisional liquidators were able to provide confirmation that, having subjected the schemes to independent scrutiny, the schemes were fair and should be sanctioned – this meant that the bar for the challenging creditor to surmount was higher than if restructuring provisional liquidation had not been used.

COMI shift

- For the purpose of US recognition and enforcement, there was a shift of the scheme companies' COMI to the Cayman Islands prior to restructuring provisional liquidators being appointed – this shift included the creation of a Cayman Islands restructuring subsidiary and is the first pre-filing COMI shift to the Cayman Islands.
- As the Cayman Islands is a tax neutral jurisdiction the COMI shift did not result in adverse tax consequences for the companies.
- The New York court expressly recognised that Cayman Islands exempted companies can have their COMI in the Cayman Islands – accepting that exempted companies can be managed from the Cayman Islands.

Other important features

- A novel court-to-court protocol was implemented between the Cayman Islands and New York courts. Information was shared between the courts so that hostile creditors could not play the courts off against each other.
- Drawing on chapter 11 litigation trusts, a Cayman Islands purpose trust (a STAR trust) was established to preserve litigation claims against third parties. The Cayman Islands STAR regime permits a trust for purposes which is ideal for a litigation trust.
- Orthodox English scheme case law was applied (including on consent fees, cross holdings and creditor opt-outs) – creating greater certainty to Cayman Islands law.

The debt

All of the Scheme Companies were cash flow and balance sheet insolvent.

The US$3.7 billion of New York law governed debt comprised of: (i) unsecured notes issued by UDW (the "UDW Notes"); (ii) secured notes issued by DRH; and (iii) secured term loans under which DFH and DOV were the borrowers. The vast majority of the debt comprised of the term loans.

UDW had guaranteed the secured debt owed by DRH, DFH and DOV (the "UDW Guarantee"). The UDW Guarantee was secured over its shares in DRH, DFH and DOV. The shares were valueless due to the insolvency of DRH, DFH and DOV.

The dissenter

Highland, an unsecured minority creditor at the bottom of the capital structure, who held 56.5% of the UDW Notes, opposed the restructuring at every opportunity – in particular, opposing the UDW scheme both at convening and sanction.

The schemes of arrangement

There were four inter-linked Cayman Islands schemes of arrangement each with a single class of creditor. The UDW scheme compromised the UDW Notes and the UDW Guarantee. The DRH, DFH and DOV schemes compromised the relevant entity's obligations under the secured notes and term loans.

Consent/lock-up fees were offered to all the DFH, DOV and DRH scheme creditors but not UDW scheme creditors. In locking-up to vote in favour of the DFH, DOV or DRH scheme (as relevant), those creditors were also obliged to vote in favour of the UDW scheme. Those creditors, who post restructuring, held a certain percentage of shares in UDW, obtained the right to appoint a UDW director.

The DRH, DFH and DOV schemes were uncontroversial. The UDW scheme was challenged by Highland – the key points of challenge are covered below.

Class

Despite Highland's opposition, the Cayman Islands court approved the single class of creditors. While the UDW Guarantee was secured and the UDW Notes were unsecured, as the security held no value, the UDW Guarantee creditors were economically unsecured and could be placed in the same class as the UDW Notes creditors.

Further, the consent fees and rights to appoint directors did not split class at UDW level because:

- the consent fee was minimal (representing less than 1% of the principal debt) and had been offered for legitimate commercial purposes as a way of determining support for the relevant schemes (rather than as an inducement to vote in favour). In any event the consent fees did not constitute a right against UDW having been paid by the silo companies and were not given as the quid pro quo for the release or variation of rights at UDW level; and
- a free floating right to appoint directors that is available to any shareholder with a sufficient holding does not create a difference in rights so as to split class.

Sanction - the litigation trust and the representative vote

Highland argued that it had the benefit of being able to bring certain fraudulent disposition claims against third parties under New York law in order to recover company property which Highland alleged had been improperly transferred away by UDW. Highland argued that, if the UDW scheme was sanctioned, the loss of creditor status under the UDW Notes would deprive it of the right to pursue those claims.

In order to deal with these allegations, UDW proposed establishing a litigation trust into which UDW's claims against these third parties would be assigned for the benefit of all UDW scheme creditors. Highland rejected the proposed solution of the litigation trust, its preference being to opt out of the scheme altogether so that it could pursue the claims directly.

The Cayman Islands court considered that the litigation trust was a fair solution, as all UDW scheme creditors would benefit equally from the trust. Highland would not be allowed to opt out of the scheme as a company is free to select the creditors that it wishes to scheme and the court could not impose on the scheme company or creditors a different scheme to the one voted on at the scheme meeting.

It was held that the UDW scheme was fair to creditors faced with the comparator of liquidation. There was no issue with the UDW scheme vote not being representative. While the UDW Guarantee creditors were obtaining the bulk of the consideration from the DRH, DFH and DOV schemes, at UDW scheme level each creditor had a common interest – avoiding a value destructive liquidation. It was for this reason that creditors would vote in favour of the UDW scheme. This was demonstrated by the fact that eight independent holders of the UDW Notes in the same position as Highland (i.e. with no claims in respect of DRH, DFH or DOV) had voted in favour of the UDW scheme..

The Ultra Make-Whole Challenge: Enforceability of Make-Whole as an Enforceable Liquidated Damages Claim under New York Law

By:
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On September 21, 2017, Judge Marvin Isgur of the United States Bankruptcy Court for the Southern District of Texas awarded a group of Noteholders (the "OpCo Noteholders") the full Make-Whole Amount triggered by Chapter 11 bankruptcy filings in the Ultra bankruptcy case (Case No. 16-32202) as well as post-petition interest. By way of brief background, Ultra Petroleum Corp. (HoldCo), Ultra Resources, Inc. (OpCo), and other Ultra entities (collectively, the "Debtors") filed for bankruptcy protection on April 29, 2016. Prior to bankruptcy, OpCo had issued multiple series of unsecured notes totaling approximately $1.46 billion, all of which were guaranteed by Holdco. OpCo was also party to a credit agreement in the approximate amount of $1 billion. The Chapter 11 cases triggered the Debtors' obligation to pay the Make-Whole Amount to the OpCo Noteholders as set out in the underlying Note Purchase Agreement, an amount in excess of $200 million. The OpCo Noteholders also claimed post- petition interest in an additional amount in excess of $100 million, given the Debtors' solvent status, classification of the Noteholders' claims as "unimpaired" under the Bankruptcy Code, and the hundreds of millions of dollars of value being distributed to structurally subordinated creditors and equity holders.

The commencement of the bankruptcy cases constituted an Event of Default under the Note Purchase Agreement, thereby causing the Make-Whole Amount to become immediately due and payable to the OpCo Noteholders. As part of their Chapter 11 plan of reorganization, the Debtors classified the OpCo Notes as unimpaired, thereby depriving the Noteholders of a vote on the plan of reorganization, yet objected to the Make-Whole Amount as well as the Noteholders' claim for post-petition interest at the contract default rate. The Debtors acknowledged that OpCo was solvent and proposed to pay post- petition interest at the much lower federal judgment rate on all OpCo claims, rather than the contract rate. Judge Isgur rejected the Debtors' arguments and followed the reasoning set forth by the OpCo Noteholders in support of their claims. The three main practice points to take away from this holding are as follows:

1. Debtors cannot apply Bankruptcy Code allowance provisions to limit recovery on unimpaired claims.

The Debtors asserted that the Make-Whole Amount should be disallowed as unmatured interest under Section 502(b)(2) of the US Bankruptcy Code. Specifically, they argued that Section 502(b)(2) precludes the allowance of the Make-Whole because it is merely a proxy for unmatured interest. However, because the Debtors classified the OpCo Notes as unimpaired under the plan of reorganization pursuant to US Bankruptcy Code Section 1124(1), the Court did not need to decide whether the Make- Whole Amount was unmatured interest under Section 502(b)(2). Section 1124(1) provides, in relevant part, that in order to classify a claim as unimpaired, all of the "legal, equitable, and contractual rights" of such claimholder must be left unaltered. The Court adopted the view that even the smallest alteration would constitute impairment and that in order to meet the unimpairment standard all amounts set out in the underlying documents must be paid.

2. Make-Whole provisions are enforceable liquidated damage provisions under New York law.

The Debtors asserted that despite classifying the OpCo Notes as unimpaired, the Make-Whole Amount was not due and owing, arguing that the Make-Whole Amount was an unenforceable liquidated damages clause under New York law. However, in defense of the Make-Whole Amount, the OpCo Noteholders argued that significant precedent existed under New York law that Make-Whole Amounts are enforceable liquidated damages provisions that constitute an appropriate measure of damages between the parties. The majority of other courts that had already resolved this issue have recognized that damages for early payment are not readily ascertainable at the time of signing a loan agreement and that make-whole provisions do not result in conspicuously disproportionate damage amounts. Judge Isgur agreed that the Make-Whole Amount was an

appropriate agreed measure of damages between the parties and the Make-Whole provision was an enforceable liquidated damages clause.

3. Where a Debtor is determined to be solvent, and the Debtor classifies a group as unimpaired, both the Make-Whole and the post-petition interest are due since these amounts redress different harms.

The Debtors argued that the OpCo Notes were unimpaired even if the Make-Whole Amount and post-petition interest amounts owing under the Note Purchase Agreement were not paid and that the payment of the Make-Whole Amount and post-petition interest at the contract default rate (rather than the much lower federal judgment rate) was "double counting." The argument was that a portion of the Make-Whole amount was calculated by reference to interest accruing on principal over the same period in respect of which post-petition interest at the default rate was also accruing. However, as the OpCo Noteholders argued, and the Judge agreed, there was no "double counting" because the Make-Whole Amount and the post-petition interest compensate for entirely separate damages. The Make-Whole Amount compensated the OpCo Noteholders for early payment of the Notes and the loss of yield that follows while the post-petition interest at the contract rate compensated for late payment on all amounts owed, including both principal and the Make-Whole Amount. Judge Isgur agreed that "the Make-Whole Amount does not lead to double recovery of actual and liquidated damages for the same injury."

4. The Debtors cannot apply the Bankruptcy Code to limit recovery on unimpaired claims.

The Debtors asserted that the Make-Whole Amount should be disallowed as unmatured interest under Section 502(b)(2) of the US Bankruptcy Code. Specifically, they argued that Section 502(b)(2) precludes the allowance of Make-Whole because the Make-Whole Amount is merely a proxy for unmatured interest. However, because the Debtors classified the OpCo Notes as unimpaired under the plan of reorganization, pursuant to US Bankruptcy Code Section 1124(1), the Court did not need to decide whether the Make-Whole Amount was unmatured interest. Section 1124(1) provides, in relevant part, that in order to classify a claim as unimpaired, all of the "legal, equitable, and contractual rights" of such claimholder must be left unaltered. The Court held that given the unimpaired classification, the claims would not be subject to any Bankruptcy Code limitations, including Section 502(b)(2), and all amounts, including post-petition interest must be paid.

Overall, Judge Isgur's decision confirms that a Make-Whole provision is an enforceable liquidated damage provision under New York law and an appropriate component of noteholder claims in bankruptcy.

The Scheme is dead, long live the Scheme!

By Barry Cahir,
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Background

The English Scheme of Arrangement has become something of a standard bearer for European-wide and global restructuring. It offers distinct advantages in large international debt restructurings such that financial creditors will facilitate a change in the governing law of debt and security documents for non-UK debtors so that the English High Court can, without a COMI shift, assert its jurisdiction over the debtor and impose a Scheme of Arrangement (the "Scheme") on its creditors.

Recognition of Schemes

The effectiveness of the Scheme would be limited were it is not for the relative ease of having it recognised and enforced outside of the UK. Indeed, the English High Court will not act in vain and will not, therefore, sanction a Scheme unless it can be shown that it will be recognised in the relevant foreign jurisdiction/s of affected creditors. To date, this has typically been achieved by adducing evidence from an expert in the foreign jurisdiction that the Scheme will be recognised in that jurisdiction. Such evidence may be a matter of private international law, EU law or international convention and treaty.

In the context of EU law, Schemes are not specified as collective insolvency proceedings for the purpose of the Recast European Insolvency Regulation ("EIR Recast").[1] Other mechanisms currently available for EU-wide recognition of an English Scheme are the Recast Judgments Regulation[2] , the Rome I Regulation[3], The Hague Convention[4] and the Lugano Convention[5]. Each of these has it merits and demerits in the context of this paper and, it may be said, have not been challenged to the full extent of those laws.

Recognition after Brexit

What is clear, however, is that as a result of Brexit, the above-mentioned regulations will no longer have effect in the UK in the absence of a bilateral treaty between the EU and the UK and the above-mentioned conventions will not apply unless and until the UK negotiates and accedes to those conventions in its own right. Ireland will be the only English speaking, common law jurisdiction in the EU.

Schemes and Examinership Schemes in Ireland

Since at least 1963, company law in Ireland has had Scheme provisions (almost identical to the UK provisions) which may also be used by non-Irish companies. The test for non-Irish companies is similar to the test in the UK, requiring the debtor to demonstrate a 'sufficient connection' with Ireland.
The Scheme process has recently been streamlined and it is now no longer necessary to get a court order to convene the Scheme meetings. Instead this can be done by the directors themselves[6].

In 1990, an alternative scheme (the "Examinership Scheme") was introduced which has since become a recognised as a collective insolvency proceeding for the purpose of EIR Recast.

The essential features of the Scheme in Ireland are:

(a) A compromise or arrangement is proposed between a company and its creditors or any class of them;

(b) Directors may convene meetings of creditors without court order;

(c) The court may order a moratorium for such period as it sees fit;

(d) Creditor approval requires a majority in number representing three-fourths in value (of each class);

(e) Court sanction hearing at which process and form, and a 'fair and equitable' / 'reasonable man' test is applied.

In *the Matter of Colonia Re Insurance (Ireland) Limited*[7] the Irish High Court approved a Scheme to shorten the timeframe involved in quantifying and paying insurance run off liabilities. Mr Justice Kelly set out five matters in respect of which the court has to be satisfied before it will sanction a Scheme as follows:

1. that sufficient steps have been taken to identify and notify all interested parties;
2. that the statutory requirements and all directions of the court have been complied with;
3. that the classes of creditors were properly constituted;
4. the issue of coercion must not arise; and
5. the Scheme must be such that an intelligent and honest man, a member of the class concerned, acting in respect of his interest might reasonably approve of it.

These five elements have been applied in subsequent cases although the fifth requirement has been re-characterised somewhat as a 'fair and equitable' test[8].

Irish Schemes are recognised in the EU

In *the Matter of Depfa Bank Plc*[9], Hypo Real Estate Holdings A.G. acquired all of the issued share capital in Depfa Bank PLC through a Scheme. The court relied on evidence of compliance with "not only the requirements of the Companies Acts but also European law requirements (including competition law and the requirements of the regulators, both here and in Germany)". Consent from the EU Commission had also been exhibited.

The existence of a dispute in the form of proceedings in Germany by a shareholder in Hypo Real Estate Holdings A.G. did not impede court sanction. An opinion from German lawyers was relied on to the effect that the claim was inadmissible, was "very unlikely" to succeed and that it would not, in any event, affect the validity of the transaction contemplated by the Scheme.

In addition, the Recast Judgments Regulation[10] , the Rome

1 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015
2 Regulation (EU) 1215/2012 of the European Parliament and of the Council of 12 December 2012
3 Regulation (EC) 593/2008 of the European Parliament and of the Council of 17 June 2008
4 The Hague Convention on the Choice of Court Agreements 2005
5 The Lugano Convention 2007
6 Section 450, Companies Act 2014
7 [2005] IEHC 115
8 In the Matter of Millstream Recycling Limited [2010] IEHC 358, Ms Justice Laffoy.
9 [2007] IEHC 4
10 Regulation (EU) 1215/2012 (recast)

I Regulation[11], The Hague Convention[12] and the Lugano Convention[13] continue to have effect in Ireland, which gives ballast and certainty to recognition and enforcement of the Scheme within the EU.

Recognition of Irish Schemes under Chapter 15 of the U.S. Bankruptcy Code

There is every reason to believe that state and federal courts in the United States will recognise Irish Schemes as 'foreign proceedings' under Chapter 15 of the United States Bankruptcy Code. It is noted[14] however that recognition of Schemes to date has depended on judicial discretion and that there has been a lack of party-in-interest opposition.

The Examinership Scheme

In 1990, an alternative Scheme (the "Examinership Scheme") was introduced for debtors which are insolvent or about to become insolvent. It has since become a recognised collective proceeding for the purpose of EIR Recast. It also has the advantage of being a model for the EU Commission's 2016 Proposed Insolvency Directive on "preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures".[15]

Examinership is a debtor in possession procedure with many features comparable to Chapter 11 of the US Bankruptcy Code. On presentation of a petition, the debtor is 'under the protection of the court' and benefits from an automatic moratorium for a period of up to 100 days. The Court may also grant protection to a related debtor company if it would "facilitate the survival of the company, or of the related company, or both"[16].

Although the debtor remains in possession, creditors are protected by the appointment of an independent examiner ("the Examiner") whose primary function is to formulate proposals for an Examinership Scheme. In the Eircom case highlighted below, the terms of the Examinership Scheme were largely negotiated prior to the initial court filing.

Voting thresholds are significantly lower than for the Scheme. Classes of creditors approve the Examinership Scheme by majority in number representing a majority in value of the claims represented at a meeting of each class. Only one class of creditors is required to approve the Examinership Scheme and dissenting classes can be, and have been, dragged along.

Once approved by one class, the Court will consider whether the proposals in the Examinership Scheme are fair and equitable to the creditors, including any class which has rejected the proposals. This is typically measured by reference to the likely outcome in a liquidation. The value break can and does give rise to litigation but there is no absolute priority rule.

If the Examinership Scheme is approved by the court, it will fix a date for the moratorium to be lifted and the Examinership Scheme to take effect.

The primary steps in the process may therefore be summarised as follows:

(a) Presentation of petition and initial ex parte hearing (at which an interim Examiner may be appointed);

(b) Full hearing of petition on notice to interested parties;

(c) Appointment of an Examiner;

[11] Regulation (EC) 593/2008
[12] The Hague Convention on the Choice of Court Agreements 2005
[13] The Lugano Convention 2007
[14] The Thing about Schemes in the Scheme of Things: Recognition of Schemes of Arrangement under Chapter 15 of the U.S. Bankruptcy Code, David L. Lawton and Shannon B. Wolf, Bracewell LLP, INSOL International Technical Series Issue No. 38
[15] Available at: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=COM:2016:0723:FIN
[16] Section 517(2) Companies Act 2014

(d) Examiner formulates proposals for an Examinership Scheme;

(e) Examiner convenes meetings of creditors to consider the Examinership Scheme and vote;

(f) Voting for each class is by simple majority in number representing a simple majority in value

(g) Provided one class of creditors has approved the Examinership Scheme, court asked to approve the Examinership Scheme;

(h) Examinership Scheme approved (subject to an overriding 'unfair prejudice' test), moratorium lifted and the Examinership Scheme takes effect.

Automatic Recognition and Enforcement of Examinership Scheme throughout the EU

Examinership is expressly included in the schedule to EIR Recast[17]. As such, an Examinership Scheme is widely recognised and enforceable throughout the EU.

Recognition and Enforcement of Examinership Scheme under Chapter 15 of the U.S. Bankruptcy Code

To the extent that recognition of Schemes may be vulnerable to challenge as highlighted above, the Examinership Scheme appears to fit more easily into the mould for recognition under Chapter 15 of the U.S. Bankruptcy Code because it is demonstrably 'a collective judicial ... proceeding ... under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation"[18].

Tried and Tested

In the matter of Eircom Limited[19], the Eircom group of companies owed €4.08bn to financial creditors. Of that amount, €2.659bn was fully secured first lien debt. The second lien debt of €350m was also secured but subordinated. A further €350m was owed to holders of Floating Rate Notes (FRNs) and €699m was owed to PIK note holders. The debtor also had significant trade and other debts. The Examinership Scheme writing €1.4bn off the total debt was sanctioned by the court within 54 days of the initial filing. It is reported[20] that the senior lenders took a 15 per cent write down on their debt, the second tier received 10 per cent of the value of their debt and the last two layers were crammed down entirely. The senior lenders became the new owners of the business. There was no objection to the Scheme.

The Irish Courts and the Judiciary

The court procedures benefit from being administered by an independent judiciary with specialist knowledge and expertise. Schemes and Examinership Schemes are also accelerated through a dedicated division of the High Court. As a result, practitioners in Ireland are very well placed to facilitate and support their international colleagues in the global restructuring market.

17 Annex A and Annex B of Regulation (EU)2015/848 of the European Parliament and of the Council
18 11 U.S.C. SS101(23)
19 [2012] IEHC 107
20 Financial Times, 11 June 2012

NIKI's COMI – There can be only one!

By Marvin Knapp and Daniel Arends
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Introduction

In August 2017, Air Berlin filed for insolvency, after its main shareholder Etihad withdrew its financial support. Air Berlin's insolvency is the biggest airline insolvency in Europe with various jurisdictions involved. One of Air Berlin's most valuable assets was NIKI Luftfahrt GmbH, an airline incorporated under Austrian law and with registered office in Vienna *(NIKI)*. NIKI was kept out of insolvency to allow for an M&A process and a sale of NIKI as a going concern. However, when the designated purchaser, Lufthansa, dropped out of the deal, NIKI was left with no other choice than to file for insolvency in December 2017.

Similar to Air Berlin, NIKI's insolvency has been in the public eye for months. This article provides a chronological breakdown of the key events of NIKI's insolvency proceedings. The case has led to a conflict of jurisdiction between German and Austrian courts as both the German insolvency court of Berlin Charlottenburg (Insolvenzgericht) (the *German Insolvency Court*) and the Austrian Higher Court of Korneuburg *(Landgericht)* (the *Austrian Insolvency Court*) have assumed jurisdiction to open main insolvency proceedings. The case is an interesting example that COMI is not always obvious and that different courts may take a deviating view on the determination of COMI and in particular, on the weight attributed to individual factors in assessing where COMI is located. The case is also special because the Austrian Insolvency Court took the view that based on a successful – but at the time still challengeable - appeal against the decision of the German Insolvency Court to initiate insolvency proceedings it assumed jurisdiction arguing that there were no longer insolvency proceedings pending in Germany.

Chronology of events

On 14 December 2017 NIKI applied to the German Insolvency Court for the opening of insolvency proceedings and certain interim measures to safeguard the business.

As NIKI had its registered office in Vienna, there was a (rebuttable) presumption that NIKI's centre of main interests (COMI) was in Austria (cf. Article 3(1) of the EU Regulation on Insolvency Proceedings (2015/848) (the *EIR)*).

On the facts and in particular, given the involvement and dependence of NIKI in the operations of its shareholder Air Berlin the German Insolvency Court was satisfied that NIKI's COMI was located just one in Berlin and that the presumption was therefore rebutted. As a consequence, the German Insolvency Court assumed jurisdiction to open main insolvency proceedings.

After the signing of a sale and purchase agreement in relation to NIKI's assets with International Airlines Group (IAG), the decision of the German Insolvency Court was appealed by one of NIKI's creditors (the *Appellant*) on the basis that NIKI's COMI was not in Germany but in Austria (the *1st Appeal*). The 1st Appeal was brought under Art. 5 EIR. The appellate court (*Landgericht Berlin*) (the *German*

Appellate Court) followed the Appellant's view and held that the German Insolvency Court had been wrong to assume jurisdiction. It took the view that the presumption that a company's COMI was in the place of its registered office had not been rebutted and therefore abrogated the original order of the German Insolvency Court.

The decision of the German Appellate Court was further appealed by NIKI's German preliminary insolvency administrator before the German Federal Court *(Bundesgerichtshof*) (the *German Federal Court*) for final decision (the *2nd Appeal*).

In parallel and before the German Federal Court decided on the case, upon the application of one of NIKI's creditors, the Austrian Insolvency Court opened main insolvency proceedings in respect of NIKI in Austria on 13 January 2018. It took the view that it was not prevented from opening main proceedings because there were no parallel main insolvency proceedings pending in Germany. It held that the decision of the German Appellate Court meant that the original decision of the German Insolvency Court was ineffective with immediate effect terminating the ongoing main proceedings despite the 2nd Appeal.

After the opening of main proceedings in Austria, the officeholders in both proceedings cooperated closely to enable a sale of NIKI's assets. Such cooperation was formalised under a cooperation agreement concluded between the German insolvency administrator and the Austrian liquidator on 15 January 2018. Subsequently, the German main proceedings were converted into secondary insolvency proceedings over NIKI's assets located in Germany. Another M&A process over NIKI's assets was launched as part of the Austrian main proceedings which ultimately resulted in a sale to NIKI's founder and eponym Niki Lauda.

Question of COMI

The main focus of the German Insolvency Court's decision was on whether NIKI's COMI was in Berlin and whether the rebuttable presumption under Article 3(1) of the EIR had in fact been rebutted. Although the EIR comprehensively regulates insolvencies of international groups of companies (cf. articles 56-77), it is lacking a specific regulation as to the determination of the COMI of groups of companies.

In assessing where NIKI's COMI was located and which factors need to be taken into account in making such assessment, the German Insolvency Court considered the European Court of Justice cases of *Eurofood* (C-341/04 Eurofood IFSC Limited) and *Interedil* (Interedil Srl v Fallimento Interedil Srl and Intese Gestione Crediti SpA (C-396/09)) and reiterated that it should be possible to rebut the presumption that a company's COMI is in the place of its registered office where a comprehensive assessment of all the relevant factors which are ascertainable by third parties establishes, that the company's actual centre of management and supervision and of the management of its interests is located in another member state. In doing so, the German Insolvency Court relied upon Recital 30 of the EIR.

The German Insolvency Court named – amongst others – the following considerations which resulted in its conclusion that NIKI's COMI was in Berlin, Germany:

- NIKI is part of the Air Berlin group of companies and indirectly controlled by Air Berlin. The German Insolvency Court looked to NIKI's shareholders, which were two Austrian companies – but economically traceable to Air Berlin – which was already in insolvency proceedings in Germany.
- NIKI is part of the Air Berlin operations whose fate is determined centrally from Berlin (including after the opening of insolvency proceedings in relation to Air Berlin). NIKI itself only has one customer, namely Air Berlin which reimburses NIKI monthly pursuant to a "Cost-Plus" agreement. NIKI is contractually obliged to operate flights as directed by Air Berlin. The German Insolvency Court listed in total 31 activities which NIKI undertook from Berlin, such as flight planning, contract negotiations, budget planning, sales management etc. The court concluded that this meant that NIKI was the "extended workbench" for Air Berlin.
- The German Insolvency Court stated that NIKI's COMI was demonstrably (and objectively ascertainable) in Germany due to two main factors; a) NIKI operates 21 planes but only 3 to 6 of those are stationed in Austria (with 2 in Switzerland and the remainder in Germany); and b) there are 176 flights weekly, with 156 departing from Germany and only 20 departing from Austria.

The German Insolvency Court was therefore satisfied that NIKI's COMI was in Germany and opened main insolvency proceedings.

In the 1st Appeal, the Appellant listed the following factors demonstrating that NIKI's COMI should be held to be in Austria:

- Third parties were not in a position to see that NIKI was controlled from Germany;
- The "Cost-Plus" agreement was not something a third party has visibility on;
- NIKI's management was situated in Vienna where there were 100 people in the office, its managing director has an Austrian mobile phone number;
- NIKI paid tax in Austria and was entered into the Austrian public register for traffic, innovation and technology;
- NIKI's planes showed an Austrian national emblem which demonstrated that it was supervised by Austrian public authorities;
- NIKI's fit for flying tests were undertaken in Vienna;
- NIKI had a collective bargaining agreement for employees employed in Austria which is publicly available;
- The year-end accounts were signed in Vienna;
- Social media referred to NIKI with the terms "headquartered" in Vienna.

The German Appellate Court held that the German Insolvency Court had been wrong to assume jurisdiction and that the presumption that a company's COMI was in the place of its registered office had not been rebutted in this case. The German Appellate Court argued that the factors that had been demonstrated to the German Insolvency Court did not establish a clear picture. In particular, the German Appellate Court looked at the following factors and determined that NIKI's COMI was in Austria:

- The fact that NIKI was part of the Air Berlin group was not – by itself – determinative to rebut the COMI presumption;
- The fact that Air Berlin was practically NIKI's sole client was not necessarily relevant. COMI was concerned not with markets but with coordination and structure – the EIR uses the term "administration" of interests;
- NIKI has offices in both Berlin and Vienna and it was not disputed that almost 100 people were employed in the Vienna office;
- The managing director's domicile (in Germany) was not determinative as he was frequently travelling between Berlin and Vienna;
- NIKI had bank accounts in both Germany and Austria so that this factor (although capable of being determinative) was not determinative here;
- NIKI has an Austrian company licence and an Austrian issued aircraft operating certificate (AOC) issued by Austro Control. The fact that airworthiness is checked in Vienna is objectively ascertainable by third parties by inspecting a public register. The country that has issued the airline licences is particularly important in the airline industry as it involves arrival slots which are a significant asset – finding NIKI's COMI to be in Germany would have an impact on its AOC;
- The general public perceives NIKI to be an Austrian company, as can be demonstrated by reference to social media;
- The fact that most activities are undertaken from Germany as most flights are stationed there and most flights depart from there is not relevant as a company can have multiple establishments in the EU and be active on numerous markets;

- NIKI's employment contracts are 80% subject to Austrian law. Third parties can see this based on the collective bargaining agreement which is public. This has more weight than where employees are actually employed as the latter is not static;
- The "Cost-Plus" agreement is governed by Austrian law with jurisdiction in favour of the Vienna courts;
- The fact that Air Berlin is subject to German insolvency proceedings is irrelevant as different companies in a group can each have their own and separate COMI;
- NIKI's actions demonstrate that it believes its COMI to be in Austria. Relying on Recital 28 of the EIR, NIKI had never told its creditors that its COMI had moved from Austria to Germany.

The NIKI case is one of the rare cases where two different courts undertook a comprehensive assessment of all factors relevant for determining COMI. Both the German Insolvency Court and the German Appellate Court carefully weighed the different aspects as part of a detailed balancing exercise taking into account pertaining case law. Many factors clearly lie in the balance and could be argued in support of either analysis. Interestingly, both courts seem to refer to social media as a relevant factor. On the one hand, this could be considered obvious and rationale as social media is ascertainable by third parties. On the other hand, given how easy it is to steer social media into a certain direction, the significance of that factor is at the same time questionable.

As the German Appellate Court emphasized that the factors demonstrated to the German Insolvency Court by NIKI did not establish a clear picture, the question arises as to what extent a German court is required to examine of its own motion whether it has jurisdiction in accordance with Article 3 EIR (cf. Article 4 EIR). Pursuant to Recital 32 of the EIR, where the circumstances of the matter give rise to doubts about the court's jurisdiction, the court should require the debtor to submit additional evidence to support its assertions. This means in principle that a court may not limit its own examination as to jurisdiction on the factors and arguments put forward by the applicant but is required to seek clarification from the applicant where there are uncertainties or missing information always taking into account the urgency of the case.

Ability of the Austrian Insolvency Court to open main proceedings

The Austrian Insolvency Court considered itself permitted to open main proceedings arguing that as a result of the decision of the German Appellate Court there were no longer insolvency proceedings pending in Germany.

Article 3(3) EIR provides that where a main insolvency proceeding has been opened any proceedings opened subsequently shall be secondary insolvency proceedings. Therefore, as long as the German main insolvency proceedings were not effectively abrogated, the Austrian Insolvency Court would have only been in a position to open secondary insolvency proceedings over NIKI's assets in Austria. The question for the Austrian Insolvency Court therefore was whether the successful 1st Appeal meant that there were no longer insolvency proceedings pending in Germany or whether the decision of the German Insolvency Court was still valid given the possibility and the filing of the 2nd Appeal. Despite a statement of the German Appellate Court to the contrary, the Austrian Insolvency Court took the stance that the decision of the German Appellate Court effectively abrogated the decision of the German Insolvency Court with the result that German main proceedings were no longer pending.

The right to challenge an insolvency court's decision on grounds of international jurisdiction is stipulated in Article 5(1) EIR. However, as Article 5(1) EIR does not give any guidance on the procedure and effects of such challenge the insolvency law pertaining to the insolvency procedure in question and therefore German insolvency law applies in this respect. While clearly the better arguments are in favour of a suspensory effect of (the possibility of) an appeal, German insolvency law is not entirely clear on this point. As regards the procedure to challenge international jurisdiction pursuant to Article 5 EIR, Article 102c sect. 4 of the Introductory Code to the German Insolvency Code (EGInsO) refers to the provisions of German civil procedural law which would not have afforded an appeal a suspensory effect in the given case. The question therefore is whether despite the reference to the German civil procedural law provisions, German insolvency law can apply which stipulates that an appeal decision becomes effective only as and when such decision is final. Not affording an appeal suspensory effect would jeopardize the continuity of an insolvency proceeding which strongly argues in favour of the applicability of German insolvency law on an appeal. Given the 2nd Appeal was ultimately withdrawn by the German insolvency administrator, a clarification of that question by the German Federal Court will be left for another case.

Conclusion

The NIKI case has shown that the determination of a COMI can be highly challenging. Recital 30 of the EIR lists a multiplicity of factors relevant for determining COMI without giving guidance on their interpretation. The main decisions of the European Court of Justice on COMI provide a certain framework for making such determination but fail to give clear guidelines to national courts in particular on the determination of COMI of entities within a group of companies.

Generally, the procedural continuity of an insolvency proceeding is of utmost importance for the estate and its stakeholders. The NIKI case shows the legal uncertainty as to whether an appeal against the decision of a German insolvency court on the basis of international jurisdiction becomes effective and terminates insolvency proceedings with immediate effect or only after the appeal has been finally decided jeopardizes such continuity. The German legislator should now be called to action and to eliminate such uncertainty by clarifying that insolvency proceedings continue until an appeal against the initiation of insolvency proceedings has been conclusively decided by the courts.

Insolvency set-off in the reinsurance context in different jurisdictions

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In the reinsurance context, a usual query that arises in almost any single reinsurance transaction or contract where some money is advanced or handed over between the parties is whether it is possible to set-off mutual debts within an insolvency proceeding.

Set-off is an equitable right that allows the parties to a contract to cancel or offset mutual debts to each other by asserting the amounts owed, subtracting one from the other and paying only the balance.

The interest of the parties to set-off amounts arises, for example, in VIF (Value in Force) transactions, which imply monetizing the value in force of an insurer's individual life risk portfolio to allow such insurer to exchange the expectation of future cashflows for an upfront amount of capital. These VIF transactions, quite frequent in Europe in the last years, are structured through a reinsurance treaty whereby the cedant cedes the defined book to the reinsurer in exchange of an upfront reinsurance commission reflecting the assessment of the future profits expected to arise from such defined book of business. At the signing date of a VIF, the reinsurer shall pay a (usually) very high reinsurance commission, whereas the cedant pays an initial premium.

The right of set-off is particularly relevant in those cases where the cedant transfers the reserves to the reinsurer to enable the reinsurer to pay the reinsured claims. In these cases, the reinsurer is usually interested in being able to offset the reserves against amounts due by the cedant, especially in case of insolvency of the cedant.

This same problem arises in those cases where a reinsurance treaty provides for a premium withheld account, whereby the insurer withholds the periodic premiums collected from the policyholders up to the end of the period foreseen in the reinsurance contract in order to guarantee the fulfilment of the reinsurer's obligations. In such case, it is the cedant who needs to be entitled to offset the infringements of the reinsurer (unpaid reinsured claims) with the funds withheld.

The possibility for the parties to a reinsurance contract to offset mutual debts when one of the parties is insolvent is dealt with differently in the different European jurisdictions. Please find a brief description of the situation in Spain, the United Kingdom, France and Italy.

Spain

The possibility of offsetting payments is expressly regulated under articles 1195 to 1202 of the Spanish Civil Code. According to these articles, set-off is permitted when two persons or entities are reciprocally creditors and debtors of each other, provided that the following requirements (set out under Article 1196 of the Civil Code) are met:

(a) Each of the persons is a creditor of the other.

(b) Both debts consist of a sum of money or, when things owed are fungible, that they are of the same kind and also of the same quality, if the quality has been designated.

(c) Both debts must have matured.

(d) They are liquidated and enforceable.

(e) None of them is subject to any retention or dispute brought by a third party and of which due notice has been given to the debtor.

In light of the aforesaid, as a general rule set-off is permitted under Spanish law, provided that certain requirements are met.

However, the problem arises when one of the parties to the contract becomes insolvent. Under the Spanish Insolvency Act, the general rule is that it is not possible to set-off obligations once the insolvency of a contractual party is declared, unless the requirements for the set-off established under Article 1196 of the Civil Code are complied with before the insolvency proceedings are declared open.

Nevertheless, a large number of Scholars consider that the prohibition established under article 58 of the Insolvency Act does not apply when the credits and debts to be offset have the same origin or cause *("ex eadem causa")*. That is, when the credits and debts derive from the same contract which foresees such set-off. According to this interpretation, the set-off that is carried out in those cases is not the general legal set-off of credits and debts

of the insolvent company due to the whole number of contracts in which it is a party (situation to which article 58 of the Insolvency Act refers, according to the aforesaid Scholars) but instead, the set-off is the way of performance of the contract agreed by the parties.

The Supreme Court has also given some light on this issue very recently. In its Ruling of 13 March 2017 it says:

> *"Actually, we are not before a compensation per se (…). We find ourselves before a liquidation scenario of one single contractual relationship where obligations have arisen for both parties involved. In the rulings 188/2014, of 15 April, and 428/2014 of 24 July we have considered that in scenarios like this one, even in the case where the loans arise amongst a bankruptcy procedure, we are before a contract liquidation mechanism and not before compensations where Section 58 of the Bankruptcy Act is applicable".*

This position of the Supreme Court has been held by the Barcelona High Court of Appeal in several judgments (for instance, rulings of 9 October 2014, 26 March 2014 and 6 March 2014), where it is expressly concluded that the set-off of mutual debts arising from the same contract shall be permitted upon the insolvency of one of the parties to such contract.

However, other courts (for example, the Madrid High Court of Appeal –judgment of 8 July 2008-) and other Scholars defend the opposite interpretation: insolvency set-off is only permitted if the requirements established under article 1196 of the Civil Code are met, regardless of whether the debts to be offset derive from the same title or contract. According to the High Court of Madrid, if the possibility to set-off is extended, the principle *''par condition creditorum''* (equal treatment of creditors) would be infringed. In addition, the Scholars who defend this position (a minority) understand that if the legislator had intended to exclude from the set-off prohibition credits ''ex eadem causa'', he would have expressly stated in article 58 of the Insolvency Act.

France

Unlike in Spain, the situation under French law is clearer. Pursuant to Article L. 622-7 of the French Commercial Code, the debtor is prohibited from paying debts incurred prior to the commencement of the proceedings, subject to specified exceptions.

The set-off of connected debts (*''dettes connexes''*) is actually one of these exclusions.

Debts are considered as connected when the credits and debts derive from the same contract, or from different contracts but within the same operation (same *"ensemble contractuel"*). Since the mutual debts to be offset in the context of a reinsurance transaction would derive from the same contract or operation, the parties would be allowed to set-off such mutual debts.

In order to be able to set-off their claims, the creditors must file a proof of claim first. It is an efficient mechanism which is used quite often and allows a payment of the creditor outside the restructuring plan and without being in competition with the other creditors.

United Kingdom

Under English law, the position is also more straightforward than that under Spanish law.

The key authorities regarding insolvency set-off are Rule 14.24 (in respect of administration) and Rule 14.25 (in respect of liquidation) of the Insolvency (England and Wales) Rules 2016 (SI 2016/1024). In a liquidation, insolvency set-off applies where, *"before the company goes into liquidation, there have been mutual dealings between the company and a creditor of the company… and the sums due from the one must be set off against the sums due from the other"*. In the case of an administration, insolvency set-off only applies where the administrator has delivered notice of an intended distribution to creditors - apart from this, it also applies to mutual dealings between parties in a similar way as in liquidation.

As the name suggests, *"mutual dealings"* must be *"mutual"*. The meaning of this has developed through case law, but in brief, the parties' relationship to each other is key - the dealings must be between the same parties, acting in the same capacity, right or interest in respect of the various debts being claimed, although the debts do not need to arise from the same transaction. Therefore, if the debts are jointly owned with another party, arise by way of assignment or attachment by a creditor, or are subject to a security interest, they may not be *"mutual"* and so would not be subject to set-off.

Further, *"mutual dealings"* between two companies do not include any debts incurred or acquired where the non-insolvent party was in any way aware of the company's pending or current insolvency. For example, this includes (amongst other things) where a debt was incurred after the company went into administration or liquidation.

Subject to the above restrictions, the sums which must be set-off include broad types of amounts. It is irrelevant whether the amounts in issue are certain or less so, and the sums which must be set-off include (i) both future and presently payable sums; (ii) sums payable under either a certain or a contingent obligation; or (iii) *"fixed or liquidated"* amounts, or amounts which can be ascertained by either fixed rules or those which are a matter of opinion.

Where a sum is uncertain (because it is contingent or otherwise), it is up to the liquidator or administrator to estimate the value and inform the creditor of this value.

In the case of any future debts (i.e. sums payable by either party after the date of the declaration of the dividend that an administrator or liquidator pays to creditors) which are

being balanced as part of the insolvency set-off, they must be discounted under Rule 14.44 of the Insolvency Rules, which provides a formula to calculate the value of such future debts.

Lastly, insolvency set-off in liquidation is in theory an automatic process, which applies at the date on which the liquidation commences, with assets being treated as realised and distributed on that date (although, in practice, it will be a longer process for any set-off to be calculated and then for the liquidators to either collect or pay the outstanding relevant balance). In contrast, an administration is not an automatic process: insolvency set-off only applies from the date that the administrator has delivered notice of an intended distribution to creditors.

Italy

Finally, Italian law does not contemplate specific provisions as far as set-off in relation to reinsurance operations.

The general rule on set-off established by the Italian Civil Code allows the automatic set-off of mutual debts existing between two parties to the extent that such debts are enforceable, certain and due at the time of set-off. Even in the absence such legal requirements, mutual debtors may contractually agree to set-off their debts and the conditions thereof.

The situation is slightly different in an insolvency scenario. As a general principle, according to Article 56(1) of the Italian Insolvency Act - which also applies to compulsory administrative liquidation and extraordinary administration proceedings to which insurance and reinsurance companies may be subject - creditors of a bankrupt company are entitled to set-off their receivables with their debts vis-à-vis such company, even if not yet due.

However, pursuant to Article 56(2) of the Italian Insolvency Act, with reference to those receivables that were not yet due at the time of the opening of the insolvency proceedings, set-off is not allowed if the claims vis-à-vis the insolvent entity were purchased after the opening of the insolvency proceedings, or in the preceding year. According to Italian case law and scholars, such provision not only applies to the purchase of receivables but also to debt assumptions aimed at extinguishing debts by offsetting them with the receivables. It should be noted that no set-off is allowed between receivables arisen after the opening of the insolvency proceedings with pre-existing receivables.

In light of the above, in the context of reinsurance agreements, according to Italian law it should generally be possible to set-off debts and receivables vis-à-vis the insolvent entity, provided that both were existing prior to the opening of the relevant insolvency procedure.

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INSOL Global Insolvency Practice Course Welcomes Ninth Class

Report by Michael Veder
Course Leader, Class of 2017/2018

The successful INSOL Global Insolvency Practice Course started its ninth year with a class of 19 prospective Fellows. The diverse group consisted of insolvency professionals from 13 different jurisdictions. The first of three intensive multi-day training sessions, Module A, was presented at The Tower Hotel in London from 22 through 24 November 2018.

The Course is designed to provide the participants with a thorough insight into the major issues, debates, and theories in legal and financial topics in international insolvency. Course exercises help the participants to develop the analytical and practical skills needed to apply international insolvency rules to situations they may encounter in practice. The Course covers both the legal and financial issues involved in international insolvency.

Module A provides a broad-based introduction to (cross-border) insolvency law. Participants study the structure of insolvency law and learn about the sources of modern cross-border insolvency law. The Module A lectures cover the framework for international insolvency law, US and UK restructuring practice, an overview of developments in a number of continental European jurisdictions (France, Germany and the Netherlands), the European Insolvency Regulation, the UNCITRAL Model Law on Cross-Border Insolvency and accounting and finance. The module also includes case studies and a work out clinic that require the participants to negotiate a complicated workout and to understand management issues and appreciate the causes of business failure.

The participants in the class of 2017/18 are Jock Baird (Windeyer Chambers, Australia), Emma Beechey (New Chambers, Australia), Ashley Bell (DLA Piper, Hong Kong), Roger Bischof (Baker McKenzie, Switzerland), Guy Cowan (Campbells, Cayman Islands), Roger Elford (Charles Russel Speechlys, UK), Gavin Finlayson (Bennett Jones, Canada), Laura Hall (Allen & Overy, USA), Ferdinand Hengst (De Brauw Blackstone Westbroek, The Netherlands), Okorie Kalu (Punuka Attorneys & Solicitors, Nigeria), Andres Martinez (World Bank Group), Noel McCoy (Norton Rose Fulbright, Australia), Nicoleta Nastasie (Bucharest Tribunal, Romania), Ben Rhodes (Grant Thornton, Channel Islands), Geoffrey Simms (PT AJCapital Advisory, Indonesia), Benjamin Tonner (McGrath Tonner, Cayman Islands), Nicolas Veron (Ronico, Switzerland), Jason Weiner (Schafer and Weiner, USA), Luke Wiseman (KPMG, UK).

The feedback by way of formal evaluations was very positive. While the instructional sessions were intensive and demanding, the program also provided opportunities for socializing and networking. Module A opened with dinner at the Tower Hotel, where Tom Smith, barrister at South Square (UK), spoke about the collapse of Carillion. The second evening was spent at The Ivy Restaurant, where, with a magnificent view of London, Simon Samuels of Veritum Partners (UK) shared his views on the new regulations in the banking sector. Both dinners, which were attended by many Fellows from previous classes, provided an opportunity for the Fellows to become acquainted with each other and to network with programme alumni and faculty.

Lectures for Module A were David Burdette (INSOL International, UK), G. Ray Warner (St. John's University, USA), Hamish Anderson (Norton Rose Fulbright, UK), Stephen Taylor (Isonomy, UK), Jan Adriaanse (University of Leiden, The Netherlands), Michael Veder (Radboud University and RESOR, The Netherlands), Jean Baron, Fellow, INSOL International (CBF Associés, France,). Lucas Kortmann, Fellow, INSOL International ((RESOR, The Netherlands), Detleff Hass (Hogan Lovells, Germany), Simon Appell (AlixPartners, UK), Dolf Bruins Slot (EY, The Netherlands), Bob Rajan (Alvarez & Marsal, Germany), and Russell Downs (PwC, UK).

The participants will complete research papers prior to Module B, which is scheduled for April 2018, immediately before the INSOL Conference in New York, USA. Module B includes additional case studies, further study of the Model Law and different national insolvency systems. After Module B, the participants will sit for their oral examinations. The programme culminates with Module C in June 2018 where the participants will apply the information learned in the prior two modules in a one-week intensive insolvency workout simulation that includes a video conference court hearing before a US and a UK judge.

Finally, on behalf of the Core Committee, I express our gratitude for the support received from INSOL, its management and staff members. The success of Module A was due in large part to their kind and conscientious efforts.

INSOL New York

29 April – 1 May 2018

A preview of this edition of INSOL World will be available on the Conference App at INSOL New York. We look forward to welcoming over 800 delegates from 47 countries. A cutting edge technical programme and invaluable international networking are key elements that make INSOL conferences stand out. In addition, this year we have a number of ancillary meetings prior to the main conference. On Sunday 29 April we are holding a specialist Offshore Meeting, preceded by an Offshore Delegates welcome reception on Saturday evening. Also, on Sunday we have the Fellows forum in the morning and a small practice meeting in the afternoon.

Our thanks go to the Main Organising Committee for all their work in organising the Conference and to the Technical Committee for preparing the technical programme.

We would also like to thank our sponsors for their tremendous support of the Conference and INSOL International, which enables the association to continue to develop its projects and activities around the world.

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Strang Founders' Award

Ian Strang was the first president of INSOL International and was instrumental in creating INSOL International, laying the foundations of the association that we have today.

To recognise his achievements we have created an award in memory of Ian. The Ian Strang Founders Award provides an educational opportunity for a post graduate specialising in insolvency and turnaround to attend the annual INSOL International Academics Colloquium and the annual INSOL International Conference (when held jointly).

The Ian Strang Founders' Award provides an educational opportunity for a post-graduate specialising in insolvency and turnaround to attend the annual INSOL International Academics Colloquium and the annual INSOL International Conference (when held jointly).

The applications are now open for 2018.

The Ian Strang Founders' Award will be awarded to the best paper put forward by a postgraduate covering this specific field of study. The criteria for applying for the award are as follows:

- Be a postgraduate or early-career academic researcher in the field of law or accountancy specialising in insolvency and turnaround, or a recently qualified lawyer or accountant interested in the academic as well as the practical aspects of the subject.
- Provide a paper of not more than 10,000 words with regard to areas concerning cross-border comparative or international issues.
- This paper should be an original piece of work, which has not previously been published in the form in which it is submitted.

The paper should be submitted by the 3rd September 2018. A panel of international academics and professionals will judge the papers and make the award by the 5th October 2018. Applicants are asked to submit their CV along with the paper.

The successful applicant will:

- Be invited to attend the INSOL Cape Town Annual Regional Conference and Academic Colloquim due to be held in Europe, which will be taking place at a different time in 2019. An allowance will be provided to cover travel and accommodation.
- Have the opportunity to present the paper at the INSOL International Academics Colloquium;
- Be recognised at the conference and receive a framed certificate of the Ian Strang Founders Award.
- Be encouraged to submit the paper to the International Insolvency Review with a view to its publication. The paper will also be published on the INSOL website.

Please send your application to:
Ian Strang Founders Award
INSOL International, 6-7 Queen Street, London EC4N 1SP, UK or email to Jason Baxter at:
jason@insol.ision.co.uk

Fellow of INSOL International
International Association of Restructuring, Insolvency & Bankruptcy Professionals

Investors entering into capital relief transactions with European banks – beware the European Bank Recovery and Resolution Directive (2014/59/EU)

By:
Sonya Van De Graaff,
Fellow, INSOL International
Ed Downer
Jeremy Jennings-Mares
Morrison & Foerster (UK) LLP

Before entering into a capital relief transaction (CRT) with a European bank investors should specifically consider the European Bank Recovery and Resolution Directive (2014/59/EU) (BRRD). This article proposes some structuring tips for investors entering into CRTs, focusing on transactions with UK banks in particular. As discussed below, structuring tips with banks in other EU Member States will need to be adapted. This is because, as a directive, the BRRD is not uniformly implemented across all EU Member States and domestic insolvency laws can differ widely.

CRTs can provide banks with relief from regulatory capital requirements

A CRT is a transaction between a bank and an investor (typically a hedge fund) whereby, for an agreed price, the bank transfers some or all of its risk in an underlying portfolio of assets to an investor (usually by way of a derivative) with a view to realising some relief from its regulatory capital burden. The bank will pay a regular coupon to the investor in return for the investor agreeing to pay a principal sum on the occurrence of agreed upon events affecting the portfolio (e.g. a payment default by a borrower under a loan from the bank).

The transfer of risk must be effective for the bank to realise relief from its regulatory capital requirements. This generally requires the investor to post a sum of money (or assets) equivalent to the amount of the principal by way of collateral to the bank to secure its contingent obligation to pay the principal. The posting of collateral ensures that the bank will have no credit exposure to the investor vis a vis the investor's obligation to pay the principal to the bank on the occurrence of the agreed upon events.

The investor in turn will be concerned to ensure the return of its collateral on the occurrence of agreed events (such as the insolvency of the bank). This article focuses on this aspect of the transaction.

'Resolution tools' under the BRRD can put the investor's collateral at risk

The BRRD establishes a non-insolvency framework for the resolution of European banks deemed to be failing or 'likely to fail' and in respect of which a private solution is impractical. At the heart of the BRRD are far-reaching 'resolution tools' given to national and pan-European resolution authorities (the pan-European authority being the Single Resolution Board (SRB)). These resolution tools give the authorities power to interfere with a bank's liabilities such as the obligation to return collateral under a CRT.

An investor entering into a CRT with a bank incorporated in an EU Member State should therefore bear in mind the risk of its collateral being interfered with or even lost as a result of action taken by the authorities. An investor will not necessarily have any notice or warning that such action is about to occur.

The 'bail-in' tool is one principal concern to investors. By the stroke of a resolution authority's pen, a bank's 'eligible liabilities' can be written down, converted to equity, or released altogether.

Investors should also be aware that, as a European directive, the BRRD is subject to domestic implementation across each of the EU Member States. If the domestic implementation is inconsistent with the BRRD, the BRRD prevails, but there is still room for some divergence of implementation.

How to minimise the risk of CRTs being impacted by the bail-in tool

The bail-in tool applies to some but not all of a bank's liabilities (see (BRRD, Article 44(2)). An investor should therefore endeavour to structure the bank's liability under the CRT so as to fall within one of those exceptions.

The most relevant exceptions for these purposes are client assets and client money which are *'protected under the applicable insolvency law'* of the Member State where the bank is situated (see BRRD, Article 44(2)(c)). Given the wide divergence of insolvency laws across the Member States, bespoke advice will be necessary to ascertain the scope of the client assets and client money protections.

Client money and client assets exception – obligation to segregate the collateral is critical for UK banks

In terms of English insolvency law, client money or assets within the Custody Rules within the Financial Conduct Authority (*FCA*) Handbook should qualify for the BRRD specified 'client assets' or 'client money' exception (see Client Assets Sourcebook (*CASS*) 7.12.1 and CASS 6.7.2) and so protect the investor from the risk of its collateral being bailed-in under the BRRD.

There seems to us no reason in principle why cloaking the collateral with these protections would impact the availability of regulatory capital relief for the bank. From the bank's perspective, the principal concern is whether, on the investor's insolvency, the bank is exposed to any credit risk of the investor. The position in the UK is that the bank should, in such a situation, be entitled to retain the collateral in accordance with the terms of the CRT and, if any of the agreed upon events occurs, apply the collateral to meet the investor's obligations. The bank's regulator should grant the same de-risking characteristics in respect of the collateral as any 'un-segregated' collateral.

This conclusion bears out because the FCA Handbook provides an exception to the client asset or client money protections upon insolvency of the investor. It does so by permitting the bank to close out and net and retain any excess as security for the investor's on-going obligations under the CRT:

> When a client's obligation or liability, which is secured by that client's asset, crystallises, and the firm realises the asset in accordance with an agreement entered into between the client and the firm, the part of the proceeds of the asset to cover such liability that is due and payable to the firm is not client money. However, any proceeds of sale in excess of the amount owed by the client to the firm should be paid over to the client immediately or be held in accordance with the client money rules.[1]

Although there is no equivalent to CASS 7.11.29 in respect of non-cash collateral, there is no reason in principle why the parties could not structure the transaction so that the custody status ceases upon a trigger event (such as insolvency) of the investor (structuring appropriately so as not to breach the anti-deprivation principle).

What kinds of transactions benefit from segregation?

Whether segregation applies to cash or other assets depends on the terms of the transaction. In structuring CRTs the following should be considered.

Collateral posted under an English law ISDA Credit Support Deed (which provides that the collateral shall be posted by way of security and obliges the bank to 'use reasonable endeavours' to safeguard the collateral), will benefit from the obligation to segregate[2] as the bank has only a bare security interest.

In contrast, segregation will not be required where the bank has a right to use the asset and treat it as if legal title has been transferred (subject only to an obligation to return equivalent assets upon satisfaction of the investor's obligation).[3] Likewise, where full ownership is transferred for the purposes of securing its obligation[4] or a transfer by way of security without the combined obligation to use reasonable endeavours to segregate. Examples include transactions where collateral is posted under an English law ISDA Credit Support Annex, or other form of title transfer financial collateral arrangement under the Financial Collateral Directive[5], or the New York law ISDA Credit Support Annex (if the right to re-hypothecate has not been dis-applied).[6]

Practical Implications of segregation - cost

The extent of the investor protections may decrease the coupon paid on the CRT to the investor, since the bank's restricted ability to use the collateral may affect the desirability of the structure.

Posting the collateral with a third party bank

If the investor is concerned that the bank might have a short-fall in its client money/customer assets (even after any permitted 'taking from the general estate'), a solution may be to post the collateral with a third party institution and enter into a tri-partite arrangement for the benefit of the bank and the investor.

The bank's regulator will need to be consulted closely if such an arrangement is envisaged. CASS 6 and CASS 7 contain some provisions which will need to be kept in mind if this approach is taken.

Cross-border matters

The investor should also bear in mind complications that may arise if the bank sub-contracts with one of its branches or subsidiaries outside the EU to hold the collateral. Complex cross-border insolvency analysis may need to be considered. The investor should guard itself against any risk of this eventuality, or else discuss with the bank any such proposed arrangements in advance of entering into the CRT and, to the extent possible, structure around issues that may arise.

Conclusion

Given the divergence that can exist across the EU, each jurisdiction will present specific structuring issues. Investors should keep the BRRD (and the bail-in tool in particular) in mind when structuring CRTs to ensure their collateral gets transferred back to them in accordance with the terms agreed.

The authors would like to thank Vladimir Maly, partner at Morrison & Foerster LLP, for his input with this article.

1 CASS 7.11.29.
2 CASS 3.1.5.
3 The lower standards of conduct set out in CASS 3 will apply instead. In the case of such a 'right to use' arrangement, the only requirement is for the bank to act honestly, fairly and professionally, in accordance with the best interests of its client, when exercising its rights under and fulfilling its obligations under such an arrangement [CASS 3.1.7A] and to keep proper books and records [CASS 3.2.2].
4 CASS 7.11.1 and CASS 6.1.6R.
5 CASS 7.11.5.
6 CASS 6.1.7.

Ian Fletcher International Insolvency Law Moot Competition

By Michael Murray,
QUT Law School, Australia.

In collaboration with INSOL International, International Insolvency Institute, QUT and the Peter A. Allard School of Law at the University of British Columbia (UBC) presented the second Ian Fletcher International Insolvency Law Moot Competition (the Fletcher Moot) on 5-8 February 2018 in Vancouver, Canada.

A moot is a mock appeal hearing used as a well-established means of training law students in case preparation and advocacy skills.

The 2018 competition again attracted wide international interest, with law schools from four continents competing. Following a written submission qualifying round, judged by international experts, 8 teams made it into the preliminary oral rounds, held at the University of British Columbia (UBC). The students came from Australia, Canada, China, India, Singapore and the United States of America.

Experts in international insolvency law drawn from the ranks of retired judges, senior lawyers and professors from a wide range of common law and civil law jurisdictions volunteered to assess each team's performance in their written and oral presentation skills. Four teams reached the semi-finals – from the National University of Singapore, the Singapore Management University, UBC and the University of Queensland (UQ). These students appeared in the elegant surrounds of the Court of Appeal in Vancouver, before judges including Geoffrey Morawetz and Barbara Romaine (Canada), Paul Heath (New Zealand), Nicoleta Nastasie (Romania), Robert Drain (USA) and Daniel Carnio Costa (Brazil).

The Moot provided the students a unique opportunity to experience real-world court proceedings before international panels of highly experienced judges, academics and practitioners. Outside the moot environment, the students were also able to readily engage with the panel judges and members of the international insolvency community, as well as with their peers from the wide range of jurisdictions represented.
Emeritus Professor Ian Fletcher QC

Professor Fletcher is well known to us as an eminent scholar, internationally recognised for his outstanding achievements in the field of insolvency law. Among many awards, he was the first academic to be awarded the INSOL Scroll of Honour.

From 1994 to 2015, Professor Fletcher served as the founding Chair of INSOL International's Academics' Group, now led by Professor Mason.

Professor Janis Sarra of UBC co-hosted the 2018 with QUT and her highly regarded Annual Review of Insolvency Law conference followed, on 9 February 2018, with a number of moot judges presenting and students attending.

The MOOT problem

The competition poses a hypothetical factual and legal problem in cross-border insolvency. It is based upon a trial judge decision that is then argued before an appeal court, the moot judges. The detailed trial judge's decision brings in many issues of cross-border insolvency – the determination of a centre of main interests, and establishment, and their respective elements, forum shopping, rights of creditors, stays under the Model Law, and the benefit to the company of its restructure. The teams appear in court as senior and junior counsel, with legal arguments divided between them, with the task of the presiding moot judges being to test and challenge the students' knowledge and understanding of their arguments, their advocacy skills and their ability to maintain legal argument, often in the face of testing questions.

Details of the moot problem were announced some months ago, prepared by experienced cross-border insolvency experts. Briefly, it involved manufacturing group companies in the fictitious country of Nuzilia whose financial difficulties prompted a transfer of the controlling company registered office to New York, while maintaining the operating company's manufacturing base in Nuzilia. The controlling company then sought and obtained Chapter 11 protection in the US, under a chief restructuring officer, and a reorganisation plan. Disaffected creditors successfully applied to the Court of Insolvency of Nuzilia for the appointment of a judicial monitor; at the same time, the CRO was unsuccessful in its cross-application for recognition of the Chapter 11

proceeding as a foreign main proceeding under the Model Law, and a stay was refused. The trial judge's decision was then the subject of the moot appeal.

The winners

The winner of the 2018 competition was the home team from the University of British Columbia, [Adrian Armstrong, Alison Colpitts, Dan Franconi and Maxime Doyle] with the University of Queensland (UQ) being the runner up [Jonathan Hohl, Tessa Boardman and Georgia Bills]. Both teams presented their arguments before the final panel of senior judges - Justice David Tysoe, Court of Appeal, BC Canada, Justice Ignacio Sancho, Supreme Court of Spain and Judge Louise Adler, US Bankruptcy Court - in the Court of Appeal. The final sessions attracted large audiences.

The standard of those two teams was evident throughout the early stages of the moot, including in their written submissions, and the quality of their respective individual presentations before the appeal judges was very high.

It might be said that all teams getting through to the final round semi-finals were also winners, such is the extent of the task of preparation and training in their home jurisdictions, and the travel of long distances to compete before a truly international audience.

Other teams in the final rounds were from the Chicago-Kent College of Law, USA; the China University of Political Science and Law; the University of Alberta, Canada; and the West Bengal National University of Juridical Sciences, India.

Particular awards

The students are assessed not only on their court skills, but in the research and analysis that goes into preparing, as a team, the written submissions to the court.
The award for the best submission in the initial written submissions round went to the team from UQ.

However, it must be acknowledged that the most demanding part of any moot competition is the oral presentation to the appeal court. Individual awards were given for this important feature of mooting skills.

The best individual mooter in the final oral round was Alison Colpitts of UBC. The best individual mooter in the preliminary rounds was Jonathan Hohl of UQ. These outcomes illustrate the high quality of the final presentations from each team before the appeal judges.
Ms Colpitts now has the opportunity to visit UNCITRAL in New York or Vienna to observe the experience of the secretariat members during a session of Working Group V - Insolvency.

The Spirit of the Moot Awards were given to Shailja Agarwal and Utkash Agrawal, both of West Bengal National University of Juridical Sciences.

Discussions are under way to hold the next moot in 2019.

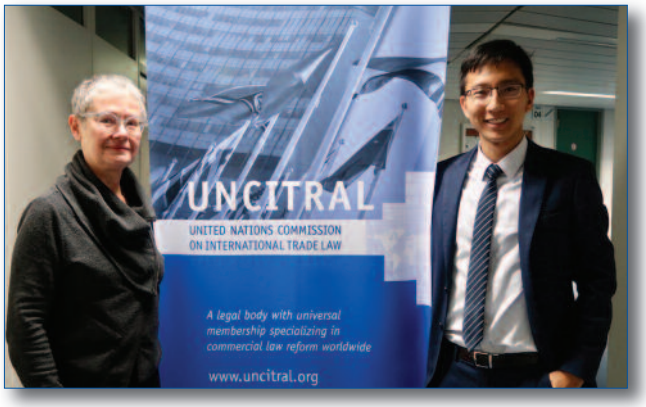
Michael Murray, QUT Law School, Australia. Michael was a moot judge in Vancouver and in Sydney in 2017. He is a member of INSOL Academics and chairs an expert advisory group of the UNCITRAL National Coordination Committee for Australia (UNCCA) in relation to Working Group V - Insolvency.

UNCITRAL WG III Meeting

By Benedict Chan Wei Qi, MOOT Winner 2017
School of Law
Singapore Management University

I was attached to the Secretariat of the United Nations Commission on International Trade Law (UNCITRAL) to observe the 34th session of Working Group III on possible reforms to Investor State Dispute Settlement (ISDS). The meeting was held from 27 November to 1 December 2017. Throughout the week, I observed the UNCITRAL Member States expressing their concerns over the current ISDS regime and deliberating whether their concerns were valid and enough cause for reforms. In accordance with UNCITRAL's tradition of inclusion, non-Member States and invited international governmental and non-governmental organisations were also invited to share their observations. Additionally, I had the opportunity to speak with the delegates of my home country, Singapore, to understand the perspective of a Member State in the discussions. In the evenings, I observed and assisted the Secretariat in the preparation of the meeting's report, summarising the content of the day's meeting.

It was truly insightful to observe the process of 60 states discussing international trade matters with a view of introducing reforms to the current ISDS framework. In particular, I enjoyed observing the complex interplay of law, politics, and economics that emerged as the meeting progressed. I am very thankful to UNCITRAL and the law faculty of Queensland University of Technology for this opportunity.



Conference Diary

April 2018				
29 Apr – 1 May	INSOL New York Annual Regional Conference	New York, NY	INSOL International	www.insol.org
29	INSOL Offshore Program	New York, NY	INSOL International	www.insol.org
May 2018				
23-25	R3 Annual Conference 2018	Vilamoura, Portugal	R3	www.r3.org.uk
24	INSOL International Yangon(Myanmar) One Day Seminar	Myanmar	INSOL International	www.insol.org
June 2018				
31 May-1 June	Eastern European Countries Committee Conference	Riga, Latvia	INSOL Europe	www.insol-europe.org
13	INSOL International - INSOL Europe - Helsinki One Day Joint Seminar	Finland	INSOL International/ www.insol.org	INSOL Europe/ FILA
July 2018				
3	INSOL International Channel Islands One Day Seminar	Jersey, Channel Islands	INSOL International	www.insol.org
11-13	INSOL Academics Colloquium	London, UK	INSOL International	www.insol.org
September 2018				
13	INSOL International Jakarta One Day Seminar	Indonesia	INSOL International	www.insol.org
October 2018				
3	INSOL International Dubai One Day Seminar	Dubai	INSOL International	www.insol.org
4-7	INSOL Europe Annual Congress	Athens, Greece	INSOL Europe	www.insol-europe.org
November 2018				
8	INSOL International Hong Kong One Day Seminar	Hong Kong	INSOL International	www.insol.org
15-16	South African Restructuring & Insolvency Practitioners Association	Cape Town, South Africa	SARIPA	www.saripa.co.za
December 2018				
1-2	INSOL India Annual Conference	New Delhi, India	INSOL India	www.insolindia.com
April 2019				
2-4	INSOL Singapore Annual Regional Conference	Singapore	INSOL International	www.insol.org
1	INSOL Offshore Programme			

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Business Recovery and Insolvency Practitioners Association of Nigeria

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Commercial Law League of America (Bankruptcy and Insolvency Section)

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We look forward to catching up with our friends and colleagues at INSOL New York and updating you on our recent endeavors. More information on KRyS Global can be found at **www.KRyS-Global.com**.

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