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International Restructuring Newswire

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

Winter 2019

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To our clients and friends:

As we begin the New Year, there is no shortage of concerns that create uncertainty as to the direction of the global economy. In the US we are seeing enormous volatility in the stock market, with a broad, swift market slide at the end of 2018. The US government faced a partial shutdown in a fight over a border wall at the Mexico border. And the Trump administration is in the midst of a trade war with China. Outside the US we are seeing a slowdown in growth in the economies of Japan, China and Europe. Britain is stumbling through Brexit and Italy through economic turmoil with consequences for its enormous bond obligations.

Such stress on the global economy only highlights the importance of increasing our understanding of the workings of the insolvency regimes throughout the world. In this issue we have articles emanating from Singapore, Australia, Canada, the United Kingdom and the United States. The US article focuses on developments in the use of the UNCITRAL Model Law on Cross-Border Insolvency. The law, enacted in the US as Chapter 15 to the Bankruptcy Code, is designed to assist in insolvencies involving companies with assets or creditors in more than one country.

The use of Chapter 15 by foreign insolvency representatives has grown exponentially with over 42 cases filed in the US in 2018. Foreign representatives sought recognition for insolvency proceedings from 19 different countries, including two or more each from Argentina, Brazil, the BVI, Canada, the Caymans, Germany, Singapore, and the United Kingdom. Of these 42 cases, 34 were granted recognition, 7 are still pending, and one petition was denied recognition. These Chapter 15 cases have been filed in courts throughout the US, with the most (21) filed in the Southern District of New York. The article beginning on page 17 of this issue focuses on significant developments this past year in the interpretation and implementation of Chapter 15.

Given the current stress in our global economy, what better time to focus on the workings on the UNCITRAL Model Law?

All the best for the New Year.

Howard Seife
Global Head
Financial Restructuring and Insolvency

In the news

October

Milan, Italy: October 17—18, 2018
At the invitation of IWIRC, Lee Pascoe participated in the 14th International Insolvency & Restructuring Symposium. She presented on a panel of lawyers and blockchain specialists on the impact of insolvency on cryptocurrency, smart contracts and initial coin offerings. The panel explored the issues insolvency practitioners may face when dealing with appointments to financially distressed digital currency exchanges or ICOs and also considered the current status of the Mt. Gox insolvency proceedings in Japan.

December

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

DiversityFIRST Leadership Award

Ryan Manns was honored with a DiversityFIRST Leadership Award by the Texas Diversity Council at the annual Greater Dallas Best Practices and DiversityFIRST Awards Luncheon on October 17, 2018.

The Texas Diversity Council's Individual DiversityFIRST Leadership Award is given annually to individuals who "demonstrate outstanding accomplishments in the promotion and advancement of diversity through inclusion and strong leadership." The selected recipients advocate for inclusivity as well as make an impact on the community.

INSOL International Special Report

Noel McCoy recently authored a Special Report published by INSOL International entitled *"Will Singapore become an international centre of debt restructuring? A comparative analysis of Singapore's bold insolvency reforms."* The Special Report assesses the likely success of Singapore's recent legislative reforms in achieving its goal of becoming an international centre of debt restructuring, approaching the status of London and New York.

Singapore's efforts to become an international hub for debt restructuring

Kei-Jin Chew

Singapore's recent changes to its insolvency and debt restructuring regime have attracted much interest in the international restructuring world. The intention behind these changes is clear – it is to make Singapore an international centre for debt restructuring.

The starting point of the current changes to the insolvency laws was the appointment of the Insolvency Law Review Committee in December 2010 to review the then existing personal and corporate insolvency regimes. Amongst other things, the committee looked at ways to improve the overall framework for insolvency proceedings and regimes for liquidations, judicial management, schemes of arrangement and receivership. It delivered its report in 2013 with recommendations which included key changes that it felt were needed to modernize Singapore's insolvency laws and it set out a roadmap for the drafting of detailed and specific statutory provisions.

This was followed up with the establishment of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring. It was tasked with recommending initiatives and legal reforms that should be undertaken to enhance Singapore's prominence as an international debt restructuring centre. It released its report in 2016.

A three-stage process of legislative changes was planned.

The first stage was the introduction of amendments to the Bankruptcy Act in 2015. Currently, the Bankruptcy Act governs personal insolvency. Corporate insolvency is governed by the Companies Act.

The second stage comprised the introduction of amendments to the corporate insolvency regime in the Companies Act. These amendments were implemented in May 2017. In a little over a year, close to 100 applications were filed in the courts by distressed companies under the new Companies Act provisions.

The third stage will be the introduction of an omnibus insolvency act which will consolidate the corporate and personal insolvency laws into a single statute and introduce further changes as well as include enhancements to some of the amendments introduced in May 2017.

To this end, the Insolvency, Restructuring and Dissolution Bill was passed by Parliament in October this year and it is expected to come into force sometime during the course of 2019.

Stage one – amendments to the Bankruptcy Act

Two of the main changes made to the Bankruptcy Act in 2015 were:

(a) making "institutional creditors" appoint a private trustee as opposed to relying on the Official Assignee (i.e. the public official appointed as the trustee of a bankrupt's estate) to administer a bankruptcy. The rationale behind this amendment was to cause creditors to consider the cost of administering the bankruptcies of their debtors and lead to more prudent lending;

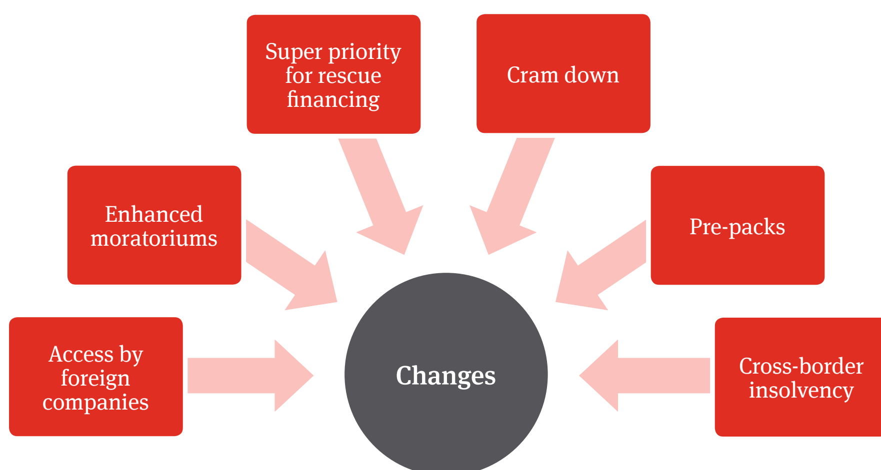
(b) a new more rehabilitative framework for the discharge of bankrupts was introduced. It gives the bankrupt clear goals and timelines to meet to become eligible for discharge.

Stage two – amendments to the Companies Act

The main changes were to increase and clarify the jurisdiction of the Singapore courts to hear and deal with debt restructuring applications, introduce automatic and enhanced moratoriums in support of such applications, provide for super priority for rescue financing, introduce "cram down" provisions to address the problem of

minority dissenting creditor classes in certain situations, allow pre-packaged restructurings, abolish the "ring-fencing" rule under which Singapore liquidators of foreign companies had to utilize assets located in Singapore to first satisfy debts incurred in Singapore and adopt the UNCITRAL Model Law on Cross-Border Insolvency.

Main changes in a snapshot



Jurisdiction / access by foreign companies - Under the previous insolvency regime, only a foreign company which fell within a very narrow definition of "foreign company" could turn to the jurisdiction of the Singapore courts and avail itself to the debt restructuring provisions of the Companies Act. This has changed. A "foreign company" can now make a debt restructuring related application to the Singapore courts if it has "a substantial connection" with Singapore. What constitutes a "substantial connection" includes factors such as the company:

(a) having its centre of main interests (COMI) in Singapore;

(b) carrying on business or having a place of business in Singapore;

(c) being registered as a foreign company in Singapore;

(d) having chosen Singapore law as the law governing a loan or other transaction or the resolution of a dispute arising out of a loan or other transaction; or

(e) having submitted to the jurisdiction of the Singapore courts for the resolution of one or more disputes relating to a loan or other transaction.

These factors are listed in the Companies Act to give a greater degree of clarity and certainty as to when a foreign company is able to demonstrate the "substantial connection" required for the Singapore courts to assume jurisdiction over its debt restructuring efforts.

Automatic / enhanced moratorium - Previously, a company seeking a moratorium to protect itself from unilateral creditor actions while it tried to put together a scheme of arrangement could make an application to the court for a moratorium but only if it had already proposed a restructuring proposal to its creditors or, as held by the court in *Re Conchubar Aromatics Ltd and other matters* [2015] SGHC 322, it had a proposal that was sufficiently detailed as to indicate that there was something definitive that could be put to the creditors shortly and the application for the moratorium was *bona fides*.

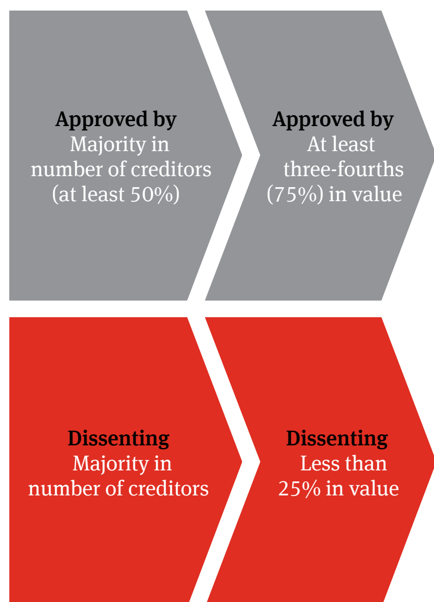
A company can now apply for a moratorium if it had proposed or *intends to propose* a compromise or arrangement with its creditors and an automatic moratorium of 30 days would "kick-in" upon the filing of the application.

Also, when hearing and granting the moratorium applied for, the court has the power to grant a moratorium with *in personam* worldwide effect.

Further, the court can grant a moratorium in respect of holding company, ultimate holding company and subsidiary companies (provided certain conditions are satisfied).

"Cram Down" - Until the changes introduced in May 2017, any scheme of arrangement needed the approval of every class of creditors amounting to not less than 75% in value and 50% in number in each class. This meant that as long as a class of creditors refused to approve the scheme, even if they represented a small proportion of the company's total debt, the scheme would be voted down.

Post-May 2017, the court has the power to approve a scheme even if a class of creditors opposes it. The requirements are illustrated below:



Approval of Scheme

- Notwithstanding that there is no requisite approval from every class of creditors, the court may approve the scheme, if:

(1) the scheme was agreed by the majority in number of creditors meant to be bound by compromise, who were present and voting (in person / proxy); and

(2) such majority in number represent three-fourths (75%) in value of the creditors (combining all classes of creditors for these purposes) meant to be bound by compromise, who were present and voting (in person / proxy); and

(3) the court is satisfied that the compromise (a) does not discriminate unfairly between classes of creditors, and (b) is fair and equitable to each dessenting class.

Priority for rescue / DIP financing - The amendments allow priority for rescue financing. Rescue financing is defined as financing that is either:

(a) necessary for the survival of the company as a going concern; or

(b) necessary to achieve a more advantageous realization of the assets of the company than on a winding up of the company.

A company can apply for an order for priority rescue financing when (a) it has made an application for a scheme or for a moratorium or (b) there is a judicial management order in force and the judicial manager makes an application.

In *Re Attilan Group Ltd* [2018] 3 SLR 898, the court determined that as this amendment was inspired by the super priority status provisions of Chapter 11 of the US Bankruptcy Code, US case-law authorities could be helpful in illuminating how the court should construe the corresponding Singapore Companies Act provision.

The court held that granting super priority should not ordinarily be resorted to; generally, it would only be fair and reasonable to reorder the priorities on winding up and giving the rescue financier the ability to get ahead in the queue for assets in cases where there was some evidence to show that the company could not otherwise have got financing.

The safeguards and protections for creditors, both existing and new rescue financiers, include the following:

- the court will grant an order for priorities if the company would not otherwise be able to get financing (unless the priority is granted);
- there is adequate protection for holders of the existing security – the Companies Act sets out what would constitute “*adequate protection*” and it includes the court making an order for cash payment, for the provision of additional or replacement security or any other relief (other than compensation) to the holder of the existing security as compensation for the decrease in the value of its existing security;
- in the case of rescue financiers providing the new funds, so long as the rescue financing was granted in good faith, the validity of any debt incurred or security interest granted as a result of the rescue financing pursuant to an initial court order, will not be affected by any reversal or modification of the order on appeal unless the order was stayed pending the appeal before the rescue financing was provided;

Certain categories of contracts are expressly exempted because of the possible disproportionate adverse impact on markets or because they may affect the national interests of Singapore.

- in case the case of a company in judicial management, any creditor may oppose an application for priority for such rescue financing.

Pre-packaged schemes of arrangement - Provisions giving the court the power to approve schemes without a creditors' meeting were introduced. The intention is to allow a fast-tracking of pre-negotiated schemes of arrangement between debtor companies and major creditors. The threshold requirement is that not less than 50% in number and 75% in value of each class of creditors would have approved the scheme had it been put before a meeting of creditors.

Cross-Border Insolvency / UNCITRAL Model Law - To facilitate cross-border insolvency (to promote recognition of and assistance with foreign insolvency proceedings and co-operation and communication between courts), the UNCITRAL Model Law on Cross-Border Insolvency was adopted. This mirrored the approach taken in other key jurisdictions in recent years including the US, UK, the Republic of Korea and Japan.

The new provisions adhere closely to the text of the Model Law. No additional conditions to the recognition of foreign insolvency proceedings in Singapore were imposed.

Non-legislative developments

Separate from legislative amendments, the courts adopted a pro-active or Judge-led approach to managing debt restructuring applications which would be heard by a bench of judges experienced in restructuring work.

Also, Singapore initiated what is called the Judicial Insolvency Network or "JIN". It is a network of insolvency judges from around the world which aims to encourage communication and cooperation amongst national courts by pulling together best practices in cross-border restructuring and insolvency to facilitate cross-court communication and cooperation.

To date, judges from over 10 jurisdictions have joined the network. These include judges from England and Wales, Delaware and the Southern District of New York, British Virgin Islands, Bermuda, the Federal Court of Australia and New South Wales, Argentina, and Brazil.

Stage three – The Insolvency, Restructuring and Dissolution Act

Some of the key features of this act are:

(a) the ability of a company to place itself into judicial management without an order of court;

(b) personal liability on officers of a company for "wrongful trading";

(c) the ability of judicial managers and liquidators to seek third-party funding to pursue certain claims;

(d) a restriction on ipso facto clauses; and

(e) the introduction of a regulatory regime over insolvency practitioners.

Judicial management - Previously, a company could only enter judicial management pursuant to a court order. The new provision allows a company to place itself into judicial management provided its creditors agree and support it doing so.

The rationale behind this new provision is to minimize the expense, formality and delay in a company entering judicial management when there is no objection from creditors. Once a company places itself under judicial management, the process will come under the supervision of the court.

Personal liability for wrongful trading - The new act provides that if, in the course of the judicial management or liquidation of a company, it appears that the company has traded wrongfully, then the judicial manager or liquidator of a company, or the Official Receiver or, under certain circumstances a creditor or contributor of the company, can make an application to the court for a declaration that the person(s) responsible for the wrongful trading be made personally liable for the debts or liabilities incurred by the wrongful trading.

The person(s) would have had to know that the company was trading wrongfully or in the case of an officer of the company, ought to have known that the company was trading wrongfully.

Third party funding - Previously, actions to unwind transactions at undervalue or unfair preference transactions or against errant parties in transactions amounting to fraudulent

or wrongful transactions were not often pursued because of a lack of financial resources.

Now, judicial managers and liquidators will have the power to assign a portion of the proceeds of such actions to third parties prepared to fund them. This will provide stakeholders with higher recoveries if and when these actions are successful.

The significance of this provision is that with the exception of international arbitration, third party funding for litigation is still considered contrary to public policy in Singapore. Interestingly, in *Re Fan Kow Hin* [2018] SGHC, the court held that an assignment of a portion of the moneys clawed back in actions to unwind undervalue transactions or unfair preference transactions was not contrary to public policy for being champertous. In any event, this is no longer a live issue because the new statutory provisions explicitly allow for an assignment of some of the proceeds to funders.

Restriction on ipso facto clauses - New limits on the enforceability of certain types of ipso facto clauses will help a distressed company to restructure by protecting its valuable commercial contracts from being terminated by reason only that the company has embarked on restructuring efforts.

Similar restrictions on ipso facto clauses are found in US, Canadian and Australian insolvency laws and in fact, the new Singapore provision takes its language from the corresponding clause in the Canadian Companies' Creditors Arrangement Act.

To balance the interests of all the parties and stakeholders, certain safeguards have been introduced. Certain categories of contracts are expressly exempted because of the possible disproportionate adverse impact on markets or because they may affect the national interests of Singapore.

A counterparty to a contract that is not exempted may apply to the court for relief on the basis of significant hardship.

Regulatory regime for insolvency practitioners - Insolvency practitioners will be licensed and only "qualified persons" will be eligible. A "qualified person" is defined as:

(a) a solicitor;

(b) a public accountant;

(c) a chartered accountant within the meaning of s2(1) of the Singapore Accounting Commission Act;

(d) a person having such other qualifications as may be prescribed by the Minister of Law.

The amendments provide for the investigation and disciplining of insolvency practitioners for breaches of conduct. The rationale behind the introduction of this regulatory regime is to improve the standard and accountability of insolvency practitioners.

A step in the right direction

Those familiar with the insolvency laws of the US, England & Wales, Australia, Hong Kong and Canada will see the conceptual ancestry of many of the changes to the insolvency regime in Singapore. The updating of Singapore's insolvency legal landscape is still in its early days. Whether it achieves the goal of making Singapore an international centre for debt restructuring remains to be seen but it would be safe to say that the general consensus so far is that it is at the very least a step in the right direction.

Kei-Jin Chew is the Managing Director of Ascendant Legal LLC which is part of Norton Rose Fulbright Ascendant in Singapore and is in its financial restructuring and insolvency group.

Cryptocurrency and insolvency: 2018 the year in review

Lee Pascoe

Late 2017 will be remembered as the period in which everyday investors adopted cryptocurrency as an alternative investment class and rode the highs of Bitcoin at USD$20,000. In contrast, 2018 will be remembered as the year that cryptocurrency plunged and insolvency practitioners globally had to start considering how the asset class could be dealt with.

The year began with one formal insolvency proceeding in the ongoing Mt. Gox saga in Japan. By year's end courts around the world began grappling with the many issues that arise once an insolvency proceeding includes crypto-assets. Below we examine some of those insolvency proceedings and the issues that have and will continue to require the attention of insolvency professionals, lawyers, creditors and investors.

Crypto-assets as property of the insolvent estate

Russia – personal bankruptcy of Mr. Tsarkov

A fundamental issue for determination in insolvency proceedings involving crypto-assets is whether the assets form part of an insolvent estate. In 2018 an insolvency professional (**IP**), managing the personal insolvency estate of Mr. Tsarkov, applied to the Commercial Court of Moscow seeking disclosure of the contents of a cryptocurrency wallet[1], which held Bitcoin asserted to be an asset of the estate. Additionally, the IP sought orders for the production of Mr. Tsarkov's private key so he could seize the crypto-assets.

Mr. Tsarkov successfully opposed the application in the lower court on the basis that Russian law did not recognise transactions involving cryptocurrency, so it could not be an object of property rights and could not form part of the bankrupt estate. The Commercial Court agreed, finding that the legal nature of cryptocurrency meant that there was no analogy with other property rights. But the 9th Appellate Court in Moscow criticised and overturned the decision, opining that the economic value of cryptocurrency should not be arbitrarily excluded from an insolvency estate as to do so would deprive creditors of the right to satisfaction of their claims. Orders were also made requiring Mr. Tsarkov to produce the private key to the cryptocurrency wallet relevant to the crypto-assets.

Even though cryptocurrency is clearly a form of asset, some jurisdictions may allow challenges to its inclusion within a bankrupt estate. Even within jurisdictions where 'property' is defined broadly to clearly include any rights attaching to crypto-assets within the estate, debate continues as to the nature of the asset and the implication of its characterisation. For example, cryptocurrency as a currency has been doubted in the United States but whether it has the status of a commodity is yet to be judicially determined. This uncertainty may affect recovery and remedies in cases of antecedent transactions.

The failure to transfer Bitcoin - a debt for the purposes of opening insolvency proceedings

The Netherlands – Koinz Trading B.V.

In the context of opening main insolvency proceedings, under Article 3 of the European Insolvency Regulation (EC 1346/2000), the Court of Midden-Nederland considered whether a failure to comply with an obligation to transfer Bitcoin was sufficient to qualify as a debt for the purpose of opening the proceeding.

The Court had made prior orders that Koinz Trading B.V. pay mining proceeds

in Bitcoin to a third party. The order expressly prescribed payment in Bitcoin involving the transfer to Koinz Trading B.V. from the third party payer.

Koinz Trading B.V. failed to comply with the order and a petition was filed for the company's insolvency in accordance with Article 1 of the Dutch Bankruptcy Act.

In determining whether it could open the insolvency proceedings the Court considered whether there was a verifiable claim and if so, whether the obligation to pay had been satisfied.

On the first issue, the Court determined that Bitcoin represented a value and was transferable, therefore showing characteristics of a property right. A claim for payment in Bitcoin qualified for verification. With respect to payment, the Court opined that the civil obligation on Koinz Trading B.V. to pay the Bitcoin had not been met. Further, the term 'payment' refers not only to the satisfaction of a monetary claim but more generally to the satisfaction of a commitment. That commitment had not been satisfied. The Court found that the criteria for opening the insolvency proceedings was met.

The insolvency of digital currency exchanges, ICOs and miners

In 2014 Mt. Gox became the first cryptocurrency company and particularly, digital currency exchange (**DCE**)[2] to be subject to formal insolvency proceedings. However, in 2018 Bitgrail Srl in Italy and Cointed GmbH, in Austria rounded out the trifecta of DCEs facing bankruptcy proceedings. With the downturn in cryptocurrency trading, inevitably other parts of the market suffered including mining firms[3] and companies that enthusiastically sought investors' money, via ICO fundraising, for projects that never eventuated.

Austria – Cointed GmbH

Cointed GmbH was founded in Austria in 2016 and had a meteoric rise, with businesses in multiple European hubs and sales of 150 million Euro in 2017. The holding company of the Cointed Group, it operated a DCE, cryptocurrency mining business, and one of the largest networks of cryptocurrency ATMs in Austria and Eastern Europe. In September 2018 the company quietly filed for bankruptcy in the Innsbruck Regional Court.

Controversy arrived at Cointed GmbH in early 2018 following an investigation by the Austrian Economic authorities into allegations of fraud, a pyramid scheme, and breach of regulations associated with the issue of the prospectus for the Cointed Group's ICO[4]. A raid of Cointed GmbH's office and seizure of company property followed. Investigations escalated and claims of embezzlement ensued after clients of the company's DCE alleged that fiat currency intended for exchange through the DCE had simply disappeared. Concerns peaked in mid 2018 when customers began experiencing long delays in attempts to withdraw fiat currency from the DCE and by August 2018 access to customer accounts had ceased.

The company's CEO confirmed financial difficulties in July 2018 but appeased investors with news that he was speaking to investors in China with a view to comprehensively restructuring the company. It appears the CEO instead relocated to China, joined the board of Cointed's Hong Kong based shareholder (Cointed Limited) and facilitated a transaction in which Cointed Limited became the holding company of the Cointed Group.

Because the prospectus for the ICO represented the Austrian entity, as the holding company with the assets of the Cointed Group, the trustee is expected to undertake a detailed investigation into inter-company property transfers prior to the bankruptcy filing. Should there be a need to recover crypto-assets improperly transferred prior to bankruptcy, it may be an appropriate opportunity to revisit the decision in *In re Hashfast Technologies LLC*. That decision held that, for the purpose of section 550(a) of the US Bankruptcy Code, Bitcoin was not equivalent to US dollars[5].

Italy – BitGrail Srl

BitGrail Srl, an Italian DCE, with users in multiple jurisdictions, first experienced difficulties in late October 2017 after approximately 17 million Nano[6] was stolen from users of the DCE who had their asset stored in wallets on the exchange[7].

Users immediately experienced difficulty in accessing their crypto-assets and exchanging fiat currency. Despite various assurances and settlement

The preferred course for token holders therefore appears to be to try to establish their claims as creditors.

proposals by the director of BitGrail Srl, by mid year a representative 'customer creditor'[8] filed a bankruptcy petition under article 6 of Italian bankruptcy law. In May 2018, orders were made by the Italian courts, that all assets of the company (including the crypto-assets contained in customer wallets on the DCE), be brought under the control of an appointed trustee pending further order.

Rather than produce the keys to enable the assets to be brought under the trustee's control, the owner of BitGrail Srl instead attempted to reopen the DCE. The Italian courts moved swiftly, ordering on 5 June 2018, that all cryptocurrency stored in wallets owned and operated by BitGrail Srl be seized and transferred to the trustee.

A final determination on the bankruptcy of BitGrail Srl is pending with much depending on the trustee's report. A decision following the court hearing on 11 December 2018 is expected in the late December 2018/early January 2019.

If the company's bankruptcy is confirmed, the most significant issues are likely to be the status of customers of the exchange, including whether they are creditors or whether the manner in which the crypto-assets were held on the DCE gives rise to some other legal status. Consideration will also need to be given to whether a distribution to creditors is made in cryptocurrency or fiat currency and how the pari passu rule will be employed in circumstances where only one form of cryptocurrency was the subject of the theft yet all crypto-assets were seized.

Japan – Mt. Gox

Mt. Gox, the first insolvency proceeding involving a DCE, commenced in the Tokyo District Court on 28 February 2014 following the disappearance of 744,800 Bitcoins with equivalent value of approximately US$473M. Initially filed as a civil rehabilitation proceeding, the Court subsequently dismissed the application in favour of appointing a trustee in bankruptcy and ordering that the company be wound up.

The Mt. Gox bankruptcy illustrates many issues that can confront an insolvency professional in the liquidation of a cryptocurrency business, including cross-border matters. Upon appointment, the Japanese trustee moved quickly to apply for chapter 15 recognition of the bankruptcy proceeding in the United States and sought equivalent orders in Canada in an attempt to stay pending and active class actions in both jurisdictions. The borderless nature of cryptocurrency businesses means that applications for cross-border insolvency recognition are likely to become more common following appointment.

Between 2014 and late 2017, the trustee successfully recovered some 200,000 Bitcoin. With the co-operation of a DCE and following court approval, tranches of the crypto-assets were sold between December 2017 and February 2018 generating some JPY$42,988,044,343. Even though the trustee sought Court approval for the method and timing of the sale of the crypto-asset, the simultaneous sale of significant quantities of the token led to criticism that the trustee's actions had triggered the Bitcoin bear market.

It became apparent in the course of the case that the available assets would exceed the provable creditor claims. Accordingly, on 24 November 2017 a group of creditors petitioned the court for conversion of the bankruptcy proceeding to a civil rehabilitation proceeding. On 22 June 2018, in a first for Japanese bankruptcy law, the Court granted the request.

Japanese bankruptcy proceedings require creditors with non-monetary claims to convert those claims into a fiat currency value as of the commencement of the bankruptcy. Civil rehabilitation proceedings do not require the claim conversion and provide more flexibility to the trustee with respect to the method of distribution to creditors via a rehabilitation plan.

Current indications are that the trustee will reimburse Mt. Gox creditors, wholly or in part, with Bitcoin at current market prices. Even though the price of Bitcoin has decreased in recent months, this recovery will remain a significant windfall for creditors who held Bitcoin in 2014[9]. Fiat currency held by the trustee will be paid to creditors with ‘cash’ claims prior to any distributions of fiat currency to creditors with cryptocurrency claims.

Distributions are expected to begin in mid-2019, subject to the implementation of the civil rehabilitation plan.

Switzerland/Germany – Envion AG

Envion AG had been battling allegations of criminality for some time prior to the business grinding to a halt and a formal decision to liquidate the company on 14 November 2018. The liquidation will be conducted by the bankruptcy authority in Zug, Switzerland in accordance with the Swiss Act on Debt Enforcement and Insolvency, marking the first use of the legislation for a crypto-currency liquidation and the first bankruptcy globally of a major ICO.

In addition to its mining operations, Envion AG issued an ICO in early 2018, raising approximately USD$100 million from some 39,000 investors who purchased “EVN tokens” valued at approximately USD$1 each. The White Paper[10] promoting the ICO represented that EVN token holders would receive the benefit of participating in revenues generated by the success of the crypto-mining company. The ICO did not hold the appropriate banking licence and was allegedly unauthorised. The EVN tokens last traded at approximately 5 cents each.

Two critical issues are likely to play out in the liquidation. First, the treatment of ICO investors and in particular, whether they are characterised as shareholders or creditors. Second, how (if at all) investors will be paid distributions given the (Revised) EVN Subscription Agreement (**Subscription Agreement**) (issued at the time of the ICO) which prescribed that any repayments to investors are to be made in Ether.

The Subscription Agreement specifically provides that token holders have no shareholder rights nor do they have any right to a liquidation surplus. This is consistent with the position that investors in an ICO are not likened to shareholders (or equity holders). Investors in the Envion AG ICO are not likely to receive any distribution of assets from the liquidation in a shareholder capacity. The Subscription Agreement also states that token holders must waive their claims to the extent required to cover the claims of other creditors and claims arising in a liquidation process.

The preferred course for token holders therefore appears to be to try to establish their claims as creditors. A claim for damages arising from the prospectus and/or ICO is most likely and if accepted by the trustee the creditor claim will rank in priority to those of shareholders.

Under Swiss law, all bankruptcy petitions are required to be filed in Swiss francs. Token holder creditors will likely be required to convert claims, as at the date of the liquidation, from Ether (and potentially EVN initially) to Swiss francs. The claim could then be adjudicated with all claims in fiat currency. This was the course initially adopted in Mt. Gox before its conversion to a civil rehabilitation proceeding where Bitcoin is now being returned to creditors.

United States of America – Giga Watt Inc.

Giga Watt’s status as a cryptocurrency mining pioneer, and the world’s biggest cryptocurrency miner just 5 years ago, was not enough to protect it from a chapter 11 filing in the US District Court in Spokane, Washington on 19 November 2018. The filing marks the first significant bankruptcy of a cryptocurrency miner.

A little under 12 months ago the company was riding high on a proposal to provide turnkey mining services and custom packages for a full range of mining services from equipment sales, maintenance, and repair to private blockchain servicing. The proposal was the subject of an ICO where token holders raised USD$22.6 million in exchange for Giga Watt tokens and the

promise that they would receive hosting services for mining computers.

The Chapter 11 filing appears to be a consequence of the ICO project being overly ambitious in a volatile cryptocurrency market. Following Giga Watt's failure to deliver on a number of ICO deadlines, two class action lawsuits were issued by ICO investors alleging impropriety in relation to the ICO.

As in the Swiss case of Envion AG, the United States courts will need to consider the rights of the Giga Watt token holders under the US Bankruptcy Code.

When determining rights of token holders consideration must always be given to the description of the token holders' interests in the White Paper. In the Giga Watt White Paper the tokens, subscribed as part of the ICO, appear to be true utility tokens[11] as the benefits ascribed to them were the right to use the Giga Watt mining centre for 50 years to accommodate a token holder's own mining equipment. Accordingly, token holders are unlikely to be considered members of the company, and any equity invested appears to be tied to the services proffered by the utility token. Establishing a provable debt for token holders may be difficult in the absence of a claim that sounds in loss or damages.

Global activity will continue to increase as the market dips. As many of the insolvency proceedings above have only commenced in the latter half of 2018, it can only be hoped that the next 12 months will give rise to judicial authority that may assist insolvency professionals, lawyers, and creditors alike to manage their way through the new maze of cryptocurrency insolvencies.

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[1] Digital wallets operate similarly to a wallet that stores fiat currency insofar as they are the means by which cryptocurrency is able to be accessed. A wallet is an address on a blockchain that stores a crypto trader's private and public keys, which allows the trader to send and receive cryptocurrency. Wallets can be stored online, through a digital currency exchange, on a hard drive, or a removable device such as an encrypted USB.

[2] A DCE is a place to buy and sell cryptocurrency that runs on similar principles to a stock exchange but has many features of a bank. DCEs can exchange fiat currency for cryptocurrency and vice versa and can also trade different forms of cryptocurrency. DCEs are loosely regulated in many jurisdictions and save for Japan there are no solvency or audit requirements. It is thought that many DCEs operate on fractional reserve principles similar to those within the banking sector but without the necessary regulatory requirements.

[3] Cryptocurrency miners are responsible for operating the computers (nodes) that undertake the algorithmic formulas necessary to verify cryptocurrency transactions for adding to the blockchain.

[4] ICOs are a means of fund raising for cryptocurrency enterprises which involve the issue of generally tradeable cryptocurrency tokens reflecting a specific dollar value. ICO tokens are generally referred to as 'utility' tokens indicating that there are no voting rights or entitlements to dividends attributable to the tokens. Rather, token holders are generally entitled to trade the tokens and once the funded cryptocurrency project is delivered the token ordinarily entitles a holder to various benefits such as use of the services the project delivers.

[5] The proceedings were filed in the United States Bankruptcy Court, Northern District of California under the fraudulent transfer provisions of the US Bankruptcy Code, against a person who had been paid 3000 Bitcoin in 2013 by Hashfast Technologies LLC (**Hashfast**). At the time that the payment was made the 3000 Bitcoin had an approximate value of $360,000 and had since appreciated to a value of $1.2 million. The critical issue was how the Bitcoin should be valued for purposes of recovery, should the transfer be successfully avoided. Section 550(a) of the Code states that if a transfer is avoided, the trustee is entitled to recover "the property transferred, or, if the court so orders, the value of such property." The bankruptcy trustee argued that Bitcoin was property and that the estate was entitled to recover either the 3,000 Bitcoin or their current value of $1.2 million. The defendant argued that Bitcoin was not property but rather the equivalent of US dollars that retained its "face" value as at the date of transfer.

[6] Nano is a cryptocurrency token predominantly traded on the BitGrail exchange.

[7] Following the theft a dispute ensued between the developers of the Nano (XRB) token and the owner of the BitGrail DCE because neither party accepted responsibility for the hack giving rise to the theft.

[8] The petition is allegedly filed in a representative capacity on behalf of 3,000 former customers of the BitGrail DCE. Not all former customers of the BitGrail DCE were affected by the hack with only the Nano (XRB) token being the subject of the theft. But the BitGrail DCE also traded in Bitcoin and other tokens and those other crypto-assets were held in wallets of customers on the BitGrail DCE.

[9] At the time of Mt. Gox's collapse Bitcoin was trading at USD$547 compared to its current value as at 9 December 2018 of USD$3385.

[10] A White Paper is the ICO equivalent of a prospectus issued to prospective investors interested in participating in the token purchase/ fund raising.

[11] Utility tokens are defined as a digital token of cryptocurrency issued to fund development of an IT project (usually on a blockchain) and which can be used later to purchase a good or service offered by the issuer. However, the tokens are often used in an effort to avoid securities legislation.

Review of significant Chapter 15 decisions in 2018

Francisco Vazquez

Chapter 15 of the US Bankruptcy Code provides a mechanism for obtaining recognition and other relief in aid of a foreign bankruptcy, insolvency, liquidation, or debt restructuring (i.e., a foreign proceeding) in the US. Interesting cross-border issues that implicate comity and other considerations often arise in Chapter 15 cases. This past year, US courts addressed several such issues.

One of the more interesting decisions involved the restructuring of Oi S.A., the Brazilian telecommunications company. Facing approximately BRL $65 million in debt, Oi and certain affiliates filed for bankruptcy in Brazil in 2016, and thereafter commenced ancillary proceedings in the United States, England, the Netherlands, and Portugal. Norton Rose Fulbright US LLP attorneys were heavily involved in the Oi restructuring, which was contentious and resulted in multiple decisions by the courts in Brazil, the Netherlands, and the United States. *See Review of Chapter 15 Cases in 2017: COMI Shifting is Still Possible, US Financial Restructuring Newswire* at 15 (Spring 2018).

Earlier this year, the United States Bankruptcy Court for the Southern District of New York issued an order enforcing Oi's restructuring plan, which had previously been overwhelmingly approved by creditors and confirmed by the Brazilian court, over the objection of a shareholder group. *See Chapter 15 Does Not Provide Back Door For Appeals Of Confirmed Restructuring Plans, Zone of Insolvency Blog* (July 27, 2018). The bankruptcy court rejected the shareholders' argument that the US court should delay enforcement of the restructuring plan until appeals pending in Brazil became final. According to the bankruptcy court, a delay would be equivalent to granting a stay that the Brazilian court had previously denied. The court also noted that the shareholders could seek relief in the US if they were successful on their appeals in Brazil. The bankruptcy court entered an order enforcing the restructuring plan in the US despite the pending appeals in Brazil.

In addition to *Oi*, there were several other significant Chapter 15 decisions issued this past year. The following is a brief discussion of some of the more interesting aspects of certain decisions, organized by subject matter.

Section 109(a) of the Bankruptcy Code applies in Chapter 15

The United States Court of Appeals for the Second Circuit, which includes New York, requires that an entity must be eligible to be a debtor under section 109(a) of the US Bankruptcy Code before its foreign proceeding can be granted recognition. *See Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238, 247 (2d Cir. 2013). Section 109(a) states that "only a person that resides or has a domicile, a place of business, or property in the United States. . . may be a debtor." 11 USC. § 109(a). Following the Second Circuit's decision, lower courts have regularly concluded that an attorney retainer deposited in a bank account in the US, as well as causes of action located in the US, satisfy section 109(a)'s requirements.

A retainer/a cause of action in the US satisfies section 109(a)'s requirements

Despite the relative ease of satisfying section 109(a), a former director of the debtor objected to recognition of the Australian liquidation of B.C.I. Finances Pty Ltd. and certain affiliates solely on the basis that the BCI companies were

not eligible to be debtors. *See In re B.C.I. Finances Pty Ltd.*, 583 B.R. 288 (Bankr. S.D.N.Y. 2018). The liquidators of the BCI companies obtained a judgment in Australia for breach of fiduciary duty against certain former directors.

Following the judgment, some of the former directors moved to the US. The Australian liquidators then filed petitions for recognition of the liquidation proceedings in the US to, among other things, seek discovery against the former directors that reside in New York. One of the directors opposed recognition on the basis that the BCI companies were not eligible to be debtors in the US. According to the liquidators, each of the BCI companies was eligible to be a debtor because it had property in the US in the form of (1) a retainer in the amount of $1,250, and (2) breach of fiduciary duty claims against the former directors that reside in the US.

The objecting director asked the court to deviate from existing case law and find that the retainers did not satisfy the debtor eligibility requirement because the retainers were established solely to manufacture Chapter 15 eligibility and in bad faith. The court rejected that invitation and found that the plain meaning of section 109(a) did not require an inquiry into the circumstances surrounding the companies' property. Because the retainers were property of the BCI companies in the US, the BCI companies were held eligible to be debtors.

The bankruptcy court also found that the fiduciary duty claims against the former directors that moved to New York were located in United States. The bankruptcy court applied New York choice law rules and concluded that Australian law governed the location of the claims because Australia had the "greatest interest" in the litigation for the following reasons: (i) the liquidators were appointed in Australia, (ii) the former directors were Australian citizens, (iii) the claims arose from acts committed in Australia, and (iv) any recovery would be distributed to creditors in the Australian liquidation.

Relying on the liquidators' Australian law expert, the court found that a cause of action is generally located where the defendant resides. A breach of fiduciary duty claim would likely be located where a director resides, and not where the breach occurred, as posited by the objector. The court further noted that "as a general matter, where a court has both subject matter and personal jurisdiction, the claim subject to the litigation is present in that court." Under that general principle, the claims are located in New York because the former directors reside in New York and the bankruptcy court has jurisdiction over matters affecting the debtors. The bankruptcy court found that the BCI companies were eligible to be debtors because they had property in the US in the form of retainers and causes of action.

California Bankruptcy Court imposes section 109(a) in Chapter 15 cases

Until 2018, no court outside the Second Circuit had apparently imposed section 109(a)'s debtor eligibility requirement in a Chapter 15 case. Indeed, Delaware and Florida bankruptcy courts disagreed with the Second Circuit's decision in *Barnet*. *See In re Bemarmara Consulting A.S.*, Case No. 13-13037 (Bankr. D. Del. Dec. 17, 2013); *In re MMX Sudeste Mineracao S.A.*, Case No. 17-16113 (Bankr. D. Fla. Nov. 1, 2017). But in February 2018, the United States District Court for the Northern District of California adopted the *Barnet* rationale and held that a foreign debtor must satisfy section 109(a)'s debtor eligibility requirements for its foreign proceeding to be recognized under Chapter 15. *See Jones v. APR Energy Holdings Ltd. (In re Forge Group Power Pty Ltd.)*, 2018 WL 827913 (N.D. Cal. Feb. 12, 2018).

Following his appointment in Australia, the liquidator of Forge Group Power Pty Ltd. filed a petition for recognition under Chapter 15 with a California bankruptcy court. In connection with the Chapter 15 filing, the liquidator transferred $100,000 to be held as a retainer by a law firm in California. Certain creditors objected to recognition, arguing that the retainer alone was insufficient to satisfy the debtor eligibility requirements. The bankruptcy court agreed finding that "property suggests something more than depositing money with a law firm and then filing."

On appeal, the district court affirmed the bankruptcy court's conclusion that the debtor eligibility requirements under section 109(a) apply in Chapter 15 cases. But the district court concluded that a properly established retainer that is property of the debtor at the time of the Chapter 15 filing will satisfy section 109(a)'s debtor-eligibility requirement. The district court remanded to the bankruptcy court to determine if the retainer was property of the debtor or some other type of arrangement that was not the debtor's property. On remand, the creditors withdrew their objection and the bankruptcy court granted recognition to the Australian liquidation.

Injunctive relief may be issued in connection with a foreign restructuring plan

After recognition of a foreign proceeding, a court may issue an order enforcing a debtor's debt adjustment, restructuring plan or similar arrangement in the US under Chapter 15. Such an order will typically include or be accompanied by an injunction to ensure that the plan can be implemented without interference from creditors or other parties in the US. In general, a court can grant such an injunction if (i) the traditional standards for injunctive relief are satisfied, and (ii) "the interest of the creditors and other interested entities, including the debtor, are sufficiently protected." *See* 11 U.S.C. §§1521(e), 1522.

A court can enjoin litigation notwithstanding forum selection clause

Earlier this year, the United States Bankruptcy Court for the District of Delaware issued an injunction in connection with an order enforcing an Italian restructuring. *See In re Energy Coal S.P.A.*, 582 B.R. 619 (Bankr. D. Del. 2018). Energia Coal S.p.A. was a debtor in a "Concordato Preventivo" under the Italian Insolvency Law pending before the Tribunale di Genova, Sezione Fallimentare (the "Genoa Court"). At the request of the debtor's foreign representative, the Delaware bankruptcy court entered an order granting recognition to the Concordato Preventivo as a foreign main proceeding under Chapter 15.

The debtor proposed a restructuring plan under which administrative expenses would be paid in full and unsecured creditors would receive 1% to 7% depending on the class of the claim. Following approval of the plan by the Genoa Court, the foreign representative requested an order enforcing the plan and an injunction enjoining creditors from commencing lawsuits against the debtor in the US.

Two counterparties to contracts with the debtor objected, arguing that they should not be enjoined from pursuing their contract claims against the debtor, which were governed by Florida law, before a court in Florida in accordance with the terms of their contracts. The counterparties argued that they should not have to incur the substantial cost for asserting their claims in Italy, which would put them in "financial peril." Instead, a Florida court should determine the amount of their claims and the priority of their claim and the amount of their recovery. The foreign representative agreed that a Florida court could determine the amount of the claims, but not the amount to be distributed on account of them. So the only issue in dispute was which court would determine the priority of and the amount to be distributed on account of the counterparties' claims.

The bankruptcy court concluded that a forum selection clause in a contract does not trump the comity afforded a foreign main proceeding. Although the counterparties could litigate the amount of their claims in Florida, they could not contest the priority or the amount of their recovery in the US. Instead, much like a foreign creditor would be required to file a claim in the US to recover from a US debtor's bankruptcy estate, the counterparties would be required to submit their claim to the Genoa Court to receive a distribution, despite the purported cost associated with seeking a distribution in Italy.

A court may issue a third-party release in a Chapter 15 case

In the US, a Chapter 11 plan of reorganization generally provides for a discharge of the debtor. Similarly, a foreign debt restructuring or similar arrangement will also provide for the discharge or other release of the debtor. A restructuring plan may also sometimes contain a release for the benefit of certain third parties (e.g., guarantors). Such so-called "third party releases" are controversial in the US, especially when they are nonconsensual. The United States Court of Appeals for the Fifth, Ninth, Tenth, and D.C. Circuits prohibit third party releases in Chapter 11 cases absent creditor consent. The United States Court of Appeals for the Second, Fourth, Sixth, Seventh, and Eleventh Circuits have held that a third party release may be given in a Chapter 11 case without consent in limited circumstances. The consideration for granting a third party release in a Chapter 15 case is different than in a Chapter 11 case because it is discretionary and subject to comity considerations.

A breach of fiduciary duty claim would likely be located where a director resides, and not where the breach occurred, as posited by the objector.

Avanti Communications Group PLC issued certain notes, including senior secured notes due 2023 that were guaranteed by certain of its subsidiaries. *See In re Avanti Communications Group PLC*, 582 B.R. 603 (Bankr. S.D.N.Y. 2018). Facing financial difficulties, Avanti proposed a restructuring of the 2023 notes to be implemented pursuant a scheme of arrangement under Part 26 of the Companies Act of 2006 of England and Wales. Under the scheme, (1) the 2023 notes would be exchanged for equity in Avanti, and (2) creditors would release the debtor and the non-debtor subsidiary guarantors from any claims under the 2023 notes. Creditors holding 98.3% of the outstanding 2023 notes voted in favor of the scheme. The High Court of Justice of England and Wales then sanctioned the scheme.

Avanti's foreign representative filed a Chapter 15 petition in the United States Bankruptcy Court for the Southern District of New York and requested an order granting comity and giving full force and effect to the scheme, including the releases. The bankruptcy court noted that English schemes and the related English proceedings have routinely been recognized under Chapter 15. The court further noted that third-party releases have also been enforced in Chapter 15 cases under section 1507, which generally provides that a court may grant additional assistance "consistent with the principles of comity."

In deciding to enforce the subsidiary guarantor releases, the bankruptcy court focused on four key aspects of the scheme and the releases. First, third-party releases are permissible under English law and are common in English schemes. Second, creditors had a "full and fair opportunity" to vote on and be heard on the scheme consistent with US due process. Third, the scheme was approved by the overwhelming majority of the single class of creditors affected by the scheme, and the scheme, including the releases, was binding on all members of the class regardless of their individual vote. Fourth, the failure to enforce the scheme and the third party releases could prejudice creditors and prevent the efficient restructuring of Avanti. The bankruptcy court extended comity to the scheme and entered an order enforcing it and the releases in the US.

Court may issue an injunction in support of a foreign plan even if another country may decide not to enforce the plan

At the end of October, the United States Bankruptcy Court for the Southern District of New York issued an order enforcing a foreign restructuring plan, including third party releases, even though other countries might later refuse to recognize the underlying foreign proceeding or enforce the plan. *See In re Agrokor D.D.*, 591 B.R. 163 (Bankr. S.D.N.Y. 2018).

The Agrokor Group is the largest private company by revenue in Croatia. When Agrokor fell into financial distress, the Croatian government passed a specialized insolvency law applicable only to companies of systemic importance to Croatia, including Agrokor. Following the filing of a proceeding under the new Croatian law, Agrokor's foreign representative obtained an order from the New York bankruptcy court granting recognition to the Croatian proceeding. Courts in England and Switzerland also recognized the Croatian proceeding. Similarly, the European Parliament enacted legislation that resulted in automatic recognition of Agrokor's Croatian proceeding throughout the European Union. But courts in Bosnia-Herzegovina, Montenegro, Serbia, and Slovenia denied recognition to the Croatian proceeding, principally because the new Croatian law appeared to be more concerned with protecting Croatian interests and economy rather than the interests of creditors as a whole.

Agrokor's foreign representative asked the New York bankruptcy court to enter an order enforcing Agrokor's restructuring plan in the US. The plan, which was approved by the requisite majorities of creditors and a Croatian court but remained subject to appeals in Croatia, generally provided for the restructuring of all of Agrokor's debt, including New York and English law-governed obligations. The plan also

released certain non-debtor guarantors and an indenture trustee from their liabilities. The bankruptcy court was generally not troubled by the request to enforce the plan in the US given that there was no objection filed in the US, the Croatian proceeding was procedurally fair, creditors had proper notice, and more than 78% of non-insiders by claim amount voted in favor of the plan. But the court noted that an English court might refuse to enforce the plan because of an English common law rule known as the "Gibbs rule."

According to the Gibbs rule, contractual obligations can be changed or discharged only in accordance with the law governing those obligations. Consequently, a creditor of Agrokor with claims arising from English law-governed contracts that did not vote in favor of the Croatian plan could sue Agrokor and other released parties in England notwithstanding the terms of the plan. Given the amount of English law governed debt, the bankruptcy court noted that the English court's refusal to enforce the plan would cause Agrokor's restructuring to fail. Despite this problem, the bankruptcy court found that the plan, including the third party releases, should be extended comity in the US under Chapter 15. The bankruptcy court concluded that it would enforce Agrokor's plan in the US. But unlike the court in *Oi*, the bankruptcy court delayed entry of its order enforcing the plan until the plan's approval became final in Croatia.

Foreign law does not limit the scope of discovery available under Chapter 15

A foreign representative in a Chapter 15 case may request authority to compel broad discovery from any person "concerning the debtor's assets, affairs, rights, obligations or liabilities." *See* 11 USC. §1521(a)(4). Bankruptcy courts routinely grant such relief, which is available both prior to and after recognition of a foreign proceeding.

The United States Bankruptcy Court for the Southern District of New York issued an order granting recognition to the Cayman Islands liquidation of Platinum Partners Value Arbitrage Fund L.P. and certain affiliates, and authorized the liquidators to conduct discovery in the US. *See In re Platinum Partners Value Arbitrage Fund L.P.*, 583 B.R. 803 (Bankr. S.D.N.Y. 2018).

The Cayman liquidators then requested discovery from the debtors' former accountant, including work papers and other documents and communications concerning the services performed. The accountant objected, arguing that the requested discovery was not available under Cayman law (the law governing the liquidation). According to the accountant, Cayman law precludes liquidators from obtaining an accountant's work papers because they are not the debtor's property.

The bankruptcy court was not convinced that the discovery sought was prohibited by Cayman law. And, even if the discovery was not available under Cayman law, "the scope of discovery available in the foreign jurisdiction is not a valid basis upon which this Court, in the exercise of its discretion must limit relief available to the Liquidators." The court noted that comity would weigh in favor of granting the liquidator's motion unless the Cayman court would be "actively hostile" or prevent the liquidators from using the discovery obtained. Citing a decision from the Cayman Islands Court of Appeal, the bankruptcy court found that Cayman courts are receptive to evidence obtained through US discovery even if the evidence would not available under Cayman law.

The bankruptcy court summarily dismissed the accountant's other arguments, including that the liquidators were required to first seek discovery in the Cayman Islands and that the discovery dispute was subject to arbitration under the terms of the engagement letter, and issued an order compelling the accountant to produce its work papers. The bankruptcy court's decision is currently on appeal to the district court.

The public policy exception in Chapter 15 is narrow

Section 1506 of the Bankruptcy Code provides that a court may refuse "to take an action governed by [Chapter 15] if the action would be manifestly contrary to the public policy of the United States." Courts have construed this exception very narrowly given that the legislative history indicates that this exception should be limited to the most fundamental public policies of the United States. The United States Bankruptcy Court for the District of New Jersey addressed this exception in connection with the Hong Kong liquidation of Manley Toys Ltd., at one time the seventh largest toy company in the world. *See In re Manley Toys Ltd.*, 580 B.R. 632 (Bankr. D. N.J. 2018).

Facing declining sales and significant litigation claims in the US, Manley Toys went into liquidation in Hong Kong. The liquidators then filed a Chapter 15 petition with the New Jersey bankruptcy court for recognition of the Hong Kong liquidation. Two creditors objected to the petition, arguing, among other

things, that recognition would be manifestly contrary to US public policy. In particular, the creditors asserted that they did not have notice of the Hong Kong proceeding, recognition would result in a stay that would permit the debtor to avoid complying with other US court's orders, and creditors would not be able to pursue US law based fraudulent transfer claims in Hong Kong. In addition, the liquidators were, according to the creditors, not independent because they relied on funding by other interested parties. In overruling the creditor's objection, the bankruptcy court noted that in analyzing the pubic policy exception, a court will focus on (1) the procedural fairness of the foreign proceeding, and (2) the effect of recognition on US statutory or constitutional rights.

The bankruptcy court concluded that recognition would not be manifestly contrary to US public policy for four principal reasons. First, creditors had notice of the Hong Kong proceeding. Creditors also had remedies available to them in Hong Kong should there be evidence of lack of notice. Second, entering into liquidation to stay or avoid US court orders or litigation is not manifestly contrary to US public policy. A company, even a purported "bad company," has a right to liquidate to avoid US litigation. Third, the differences between US and Hong Kong law were not fundamental public policies. The fact that certain transactions could be avoided under US law, but were not avoidable in Hong Kong reflected "a different way to achieve similar goals," not conflicting public policies. Finally, the liquidators' reliance on funding by creditors or insiders that could not be used to pursue claims against the funders did not run afoul of a US public policy. Indeed, the court noted that a US debtor will typically agree not to use funds borrowed to pursue claims against the lender. Consequently, the bankruptcy court was not troubled by the liquidators' agreement not to use funds borrowed to pursue claims against the lender, especially where the liquidator acknowledged that they would seek alternative funding to pursue such claims if they found them to be viable.

Out of money equity may lack appellate standing/ equitable mootness applies in Chapter 15

As discussed in *Review of Chapter 15 Cases in 2017: COMI Shifting is Still Possible, US Financial Restructuring Newswire* at 15 (Spring 2018), a former shareholder of Ocean Rig UDW Inc. appealed the decision of the United States Bankruptcy Court for the Southern District of New York to enforce Ocean Rig's Cayman Island scheme of arrangement in the US. The district court dismissed the shareholder's appeal for two reasons. *See In re Ocean Rig UDW Inc.*, 585 B.R. 31 (S.D.N.Y. 2018).

First, the shareholder was not an "aggrieved person" with standing to appeal the bankruptcy court's decision. A person has standing to appeal an order only if the order "directly affects" the person's pecuniary interests. Because Ocean Rig was insolvent and unable to pay its creditors in full, there was no value available for equity holders. Consequently, the scheme did not affect the out of the money shareholder, who would never be able to recover from Ocean Rig.

Second, the appeal was dismissed as equitably moot. Under the doctrine of equitable mootness, which is typically applied in a Chapter 11 case, an appeal of a restructuring plan may be dismissed where the plan has been substantially consummated and certain other facts are present. The district court concluded that the principles of finality and fairness supported the application of equitable mootness to Chapter 15 cases and dismissed the appeal as equitably moot because the scheme had been implemented and Ocean Rig's restructuring substantially completed.

Chapter 15 is exclusive avenue for certain relief

Before the enactment of Chapter 15, a foreign representative or debtor could ask a court to dismiss or enjoin a lawsuit pending before it under principles of comity. Under Chapter 15, a foreign representative's discretion to seek relief from a court before obtaining recognition by a bankruptcy court under Chapter 15 has been significantly limited. Earlier this year, the United States District Court for the Northern District of Illinois concluded that it could not stay litigation against the defendant notwithstanding that the defendant was a debtor in a Canadian bankruptcy proceeding. *See Halo Creative & Design Ltd. v. Comptoir Des Indes Inc.*, Case No. 14-C-8196, 2018 WL 4742066 (N.D. Ill. October 2, 2018). Relying in large part on one of the earliest decisions addressing a request for a stay of litigation after Chapter 15 became effective -- *United States v. J.D. Jones Construction Group LLC*, 333 B.R. 637 (E.D.N.Y. 2005) -- the Illinois district court concluded that the foreign debtor must obtain Chapter 15 recognition of its Canadian proceeding before it could obtain a stay of the litigation in the district court.

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Approval of third-party releases under the CCAA: the court lowers the bar in Aquadis

Julie Himo, Dominic Dupoy, and Arad Mojtahedi

A monitor appointed under the *Companies' Creditors Arrangement Act* (CCAA) can sue third parties in the name of the debtor to maximize the debtor's assets for its creditors.

If the monitor settles a claim with some of the defendants, they will usually insist on a full and complete court-approved release. Courts will generally approve the release if it is fair and reasonable in the circumstances and if the rights of the non-settling defendants are protected.

Summary

A recent decision has significantly lowered the standard for approving a third party release. In the matter of *Arrangement relatif à 9323-7055 Québec inc. (Aquadis International Inc.)*, 2018 QCCS 2945 (leave to appeal to the CA refused, hereinafter "*Aquadis*"), the court approved a settlement agreement (i) granting release to defendants who did not contribute to the settlement, (ii) offering no procedural protection to the non-settling parties, and (iii) offering very limited protection to the substantive rights of the non-settling parties.

The factual context

The debtor 9323-7055 Québec inc. (formerly Aquadis International Inc.) was a wholesale seller of plumbing fixtures. It suffered financial difficulties when hundreds of defective faucets it had sold failed, causing damage to property owners whose insurers ultimately filed subrogated claims against Aquadis. Those claims amounted to nearly $Cdn 22 million and the monitor estimated potential future claims at an additional $Cdn 25 million.

The monitor began proceedings against the manufacturer and the distributor of the faucets and their insurers. The court also authorised the monitor to file proceedings against the retailers who had sold the faucets, not in the name of the insolvent debtor (which had no right of action against the retailers), but in the name of the debtor's creditors (i.e., the property insurers that had filed subrogated claims against Aquadis).

The monitor received offers of settlement from the manufacturer and the distributor's insurers. The monitor sought court approval of the offers. The retailers opposed approval on the grounds the manufacturer and the distributor were being released even though they were not contributing financially to the settlement.

The retailers also argued the terms of the offers may infringe their rights to file contribution claims against the manufacturer and the distributor. To defeat that argument, the offers were amended so that the retailers' potential liability would be reduced by any sum the retailers could prove would have been recoverable from the manufacturer or the distributor had the settlement not been entered into.

The decision

The court rejected the retailers' arguments and approved the settlement offers, noting the offers were the result of a fair process and in the best interest of the creditors. The fact the manufacturer and the distributor were being granted releases although they did not financially contribute to the settlement (only their insurers contributed to the settlements) was not considered sufficiently important to deprive the creditors of the benefit of the settlement amounts.

The court also held that the comfort clause, although not perfect, was valid in the circumstances since it was consistent with article 1531 of the *Civil Code of Quebec* (**CCQ**) and with similar provisions in *Pierringer*-type agreements which essentially allow one or more defendants in a multi-party action to settle with the plaintiff and withdraw from the litigation leaving the remaining non-settling defendants responsible only for the loss they actually caused. Article 1531 CCQ provides:

> "Where, through the act or omission of the creditor, a solidary debtor is deprived of a security or of a right which he could have set up by subrogation, he is released to the extent of the value of the security or right of which he is deprived."

The court reached that conclusion even though the comfort clause was problematic for potential future claims and that, contrary to the situation usually prevailing in *Pierringer*-type agreements, the liability between the various defendants was not joint and several in the circumstances. The court did not even consider that the offers provided no protection for the retailers' procedural rights.

The retailers opposed approval on the grounds the manufacturer and the distributor were being released even though they were not contributing financially to the settlement.

Take-away

The decision in *Aquadis* shows courts may be willing to lower the bar for approval of settlement offers providing for third-party releases. If a court finds the settlement offer is beneficial to the creditors and to the restructuring or liquidation of the debtor, the criteria that have been reiterated by the leading case law may be applied with more flexibility and with less concern for the rights of third parties.

The impact of Aquadis is difficult to predict. Although leave to appeal of the first instance judgment was refused by the Court of Appeal because the settlements had been executed by the time it heard the case, the Court of Appeal felt the need to add that "[...] the effect of global releases arising from partial (as opposed to global) settlements has not been entertained by this Court and the jurisprudence in the rest of Canada is not, arguably a closed book." It will be interesting to see whether Canadian courts will follow *Aquadis* or whether they will adhere to the more stringent conditions developed by previous case law.

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Common sense prevails: Supreme Court of Canada confirms secured creditors are not liable for debtor's unremitted sales taxes

Gunnar Benediktsson

The Supreme Court of Canada has now confirmed that, following a tax debtor's bankruptcy, Canadian tax authorities cannot recover that tax debtor's unremitted sales taxes from its secured creditors who received repayments from that tax debtor pre-bankruptcy.

After a protracted dispute in the courts below, and a ruling from the Federal Court of Appeal suggesting that secured creditors were at risk of having their debt repayments clawed back by tax authorities in a bankruptcy, the Supreme Court decided that no such right of action exists. This issue has potentially wide-ranging implications for secured creditors of tax debtors who are either insolvent, or nearly so.

Relevant statutory provisions

Section 222 of the *Excise Tax Act* (the ETA) creates a deemed trust in favour of the Crown for collected but unremitted goods and services and harmonized sales taxes (**GST** and **HST**), and provides that such a deemed trust extends to "property held by any secured creditor that, but for a security interest, would be property of" the debtor. However, the ETA also expressly provides that this deemed trust does not apply at or after the time a tax debtor becomes bankrupt.

The extinguishment of the ETA deemed trust upon bankruptcy is consistent with Canadian bankruptcy law, which provides that, with certain exceptions, statutory deemed trusts do not survive bankruptcy.

Canada v Callidus Capital Corporation

Canada v Callidus Capital Corporation (2015 FC 977 (rev'd) 2017 FCA 162) involved a forbearance and "soft restructuring" agreement between Callidus Capital Corporation, as secured lender, (**Callidus**) and Cheese Factory Road Holdings Inc. (**Cheese Factory**). Callidus and Cheese Factory entered into forbearance terms in 2011, which included an agreement to deposit certain receipts from operations into a blocked account that was periodically swept by Callidus and applied to Cheese Factory's outstanding debt.

After that, Cheese Factory (at Callidus' request) made a voluntary assignment into bankruptcy.

Canada Revenue Agency commenced an action, asserting a personal right of action against Callidus for receipt of funds impressed with a deemed trust that should be returned to the Crown. Callidus argued that the bankruptcy of Cheese Factory extinguished the deemed trust, and with it any personal right of action by the Crown against Cheese Factory's secured creditor. The trial level court sided with Callidus.

The majority of the Federal Court of Appeal, in a split decision, sided with the Crown. The majority concluded that the obligation to remit sales taxes and the

deemed trust for those sales tax amounts in favour of the Crown arose prior to bankruptcy at the time the sales taxes were received from customers, and thus survived the bankruptcy of the tax debtor.

On November 8th, in reasons delivered orally from the Bench, the Supreme Court of Canada unanimously rejected the decision of the Court of Appeal. The Supreme Court concluded that any liability of a secured creditor for receipt of trust funds depended on the continued existence of the trust, and that Canadian bankruptcy law is clear that the deemed trust for unremitted sales taxes ceases to exist following a bankruptcy, regardless of the time at which that trust was created. With that, the Supreme Court of Canada has finally determined that the Crown's personal right of action against a secured creditor of a tax debtor for unremitted GST and HST is extinguished by the tax debtor's subsequent bankruptcy.

The extinguishment of the ETA deemed trust upon bankruptcy is consistent with Canadian bankruptcy law, which provides that, with certain exceptions, statutory deemed trusts do not survive bankruptcy.

Implications

The ruling of the Federal Court of Appeal created significant uncertainty and concern for secured lenders who wished to work with distressed debtors outside of bankruptcy through forbearance agreements or similar "soft restructuring" tools. The Court of Appeal would have required a tax debtor's unpaid GST and HST amounts to be reserved for and guaranteed by its secured creditors, despite the practical reality that the actual amounts of those arrears can be difficult to determine even by Canada Revenue Agency, often requiring an audit.

The Court of Appeal's ruling would also have created a strong disincentive for a secured creditor to work with a distressed borrower outside of bankruptcy to resolve its balance sheet issues. An asset-based lender or other secured creditor would have been well advised to adopt the practice of petitioning all insolvent debtors into bankruptcy prior to accepting any proceeds from receipts or the sale of assets, absent certainty that nothing is owing to Canada Revenue Agency in respect of unremitted GST or HST.

The Supreme Court's ruling will thus come as welcome news to secured lenders in Canada, who may rest assured that post-bankruptcy at least they will not be expected to make Canada Revenue Agency whole for unremitted GST or HST obligations of borrowers.

The issue of the enforceability of the ETA deemed trust outside of bankruptcy has been left to be decided another day.

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Claims against insolvency practitioners: the rising tide

Helen Fairhead

The role of an Insolvency Practitioner ("IP") has always been challenging – taking control of a company in crisis, making swift decisions based on limited information and balancing the competing interests of stakeholders; all of this requires sound judgment, often under extreme pressure. When things go wrong (or when parties feel they have lost out), IPs can become the focus of blame, and their insurance policy an attractive target for 'last resort' litigation.

The traditional situation in which an IP becomes the target of litigation is where lenders have enforced personal guarantees against the company's directors or shareholders. Faced with the prospect of paying out under the guarantee, the director or shareholder responds with a cross claim against the IP, usually along the lines that the IP breached his/her duties by failing to realise the best price when selling key assets. Claims are also sometimes brought against the secured creditor who will be said to have influenced the IP.

In the past few years, there has been a noticeable change in the type of claims brought against IPs and their firms, as well as a large uptick in their frequency. Two main themes emerge.

The first is that claims for 'underselling' are increasingly being brought as standalone actions, rather than as a defensive tactic to demands under a guarantee. See, for example, *AM Holdings v. Batten & LePage* [2018] EWHC 934 and *Davey v. Money & Another* [2018] EWHC 766 (Ch). Both of these claims were brought by the company or its shareholders as standalone claims that (*inter alia*) the IPs had undersold (failed to achieve the best price for) the company's assets. Both claims were brought after what would ordinarily be perceived as successful administrations – in AM Holdings the company returned to solvency, and in Davey unsecured creditors had received a significant dividend.

The second theme is the rise in claims based on economic torts – most notably claims for unlawful means conspiracy. *Premier Motor Auctions v. Lloyds Bank and PwC*, which was dismissed earlier this year is the most high profile of these claims, but there have been (and still are) many similar claims at various stages of proceedings. The typical allegation is that the IP or firm unlawfully conspired with a secured creditor (usually a bank) to place the company into an insolvency process with a view to extracting the associated fees and (in the case of the bank) a discounted equity stake in the company.

In this article we look at a number of cases exemplifying these themes and consider: (i) what has driven the increase in them; (ii) what tactics IPs and their firms have used to defend them; and (iii) what the future holds for this type of litigation.

What is driving the increase in claims?

The primary, unavoidable factor behind the increase in claims is the growth of the litigation funding and after-the-event (ATE) insurance market. Most IPs will be familiar with these tools, having used them to pursue claims against (for example) former directors in order to bolster the assets of the insolvent estate. The litigation funding market has experienced exponential growth in recent years. Some estimates now value the market at £2.7bn – a tenfold increase since 2009. The sheer amount of capital that litigation funders have to invest means they have inevitably had to cast the net wider when funding claims. Litigation funding has now evolved from a tool that IPs utilise to bolster the insolvent estate, into a double-edged sword that may cut the wielder.

Add into the mix the 2014 report by Lawrence Tomlinson. Although the Tomlinson Report focused upon perceived failings in the way in which banks dealt with distressed businesses, it also made a number of allegations about the role of accountancy firms, pointing to what it perceived to be

- The high potential for conflicts of interest when undertaking independent business reviews for banks, since the same firm was likely to be appointed to act as the business's administrator; and
- The "*unfair and opaque*" behaviour of administrators and receivers when in office.

The publicity surrounding the report, together with an increased appetite for litigation against large institutions following the 2008 financial crisis, has arguably created a significant impetus for those looking to pursue claims against banks, accountants and other financial institutions.

Conspiracy theory

The final and perhaps most interesting factor behind the increase in claims, is developments in the law of economic torts, in particular unlawful means conspiracy. Where two or more people act together unlawfully (the unlawful act can be civil or criminal), intending to damage a third party, and do so, unlawful means conspiracy can be alleged.

IPs are particularly vulnerable to claims for unlawful means conspiracy because they hold office personally and take appointments jointly with other IPs. This, combined with the fact their firm often has a separate advisory engagement with the company and/or one of the company's lenders, means there are multiple parties over whom a claimant can make an allegation of conspiracy.

Two House of Lords decisions in 2007-2008 clarified two key elements of unlawful means conspiracy and, made it much easier for claimants to pursue this course of action.

OBG Ltd and others v. Allan and others [2007] UKHL 21, was the first of these decisions. It confirmed the level of intention that a claimant must demonstrate to establish unlawful means conspiracy. OBG confirmed that a claimant does not need to show that the defendant's sole or predominant purpose was to injure another person, only that it was one of the defendant's purposes. The required level of intention for unlawful means conspiracy can now be established where injury to the target is a means to an end, rather than an end in itself, which is a much lower threshold. Recent cases have gone even further and the Supreme Court recently stated that the requisite level of intention can be established where damage to the interests of others was merely a 'foreseeable consequence' of the act in question.

This makes it easier for claimants seeking to plead unlawful means conspiracy. As an example, a claimant looking to bring a claim that an IP (or his or her firm) conspired with a bank to place a company into insolvency, does not need to demonstrate that the IP's sole purpose was to injure the company; he or she only needs to show that injury to the company was a means to an end; that end can, for example, be the professional fees the insolvency appointment would generate.

The second House of Lords decision was *Total Network SL v. HMRC* [2008] UKHL 19. That decision confirmed that the 'unlawful means' in question do not need to be directly actionable by the claimant against the defendant. As long as there has been an unlawful action that is actionable by someone, even if not the claimant, then (providing all the other requirements are met) a claim for unlawful means conspiracy can be brought.

The ruling that 'unlawful means' do not need to be directly actionable by the claimant has very wide implications. Individual creditors can, in theory, bring claims for unlawful means conspiracy in circumstances where they would not otherwise have a cause of action. Take claims against administrators as an example. In an administration, absent special circumstances, the administrator owes his or her duties to the company, not to individual creditors. But, if a creditor can establish that the office-holder has breached his or her duty to the company (i.e. the unlawful means), plus the requisite intention and the necessary element of combination (i.e. the conspiracy), then it could be possible for that creditor to bring a claim against the administrator (and others) for unlawful means conspiracy. We are not aware of any such claims having been pleaded, and whether such a case could ever proceed on policy grounds is debatable. But with determined claimants pleading ever more creative causes of action, it seems only a matter of time before this is attempted.

Response one: early determination

Faced with a perfect storm of available funding, cultural impetus and claimant-friendly legal developments, it is no surprise that IPs and their firms have tried to dispose of these claims at an early stage.

The English Civil Procedure Rules (CPR) provide certain mechanisms for the early disposal/determination of a claim, namely:

- An application for strike-out under CPR r3.4 on the basis that the statement of case discloses no reasonable grounds for bringing the claim or that it is an abuse of the court's process; and/or
- An application for summary judgment under CPR r24.2 on the basis the claimant has no real prospect of succeeding on the claim or issue and there is no other compelling reason why the case or issue should be disposed of at a trial.

In practice, applications made under these provisions are most likely to be successful when based on discrete points of law, contractual construction, or procedure (e.g. limitation). If the court is satisfied that it has all the evidence necessary to determine the question before it, then it is likely to decide matters. IPs may therefore benefit from considering whether any such 'killer' points can be raised at the outset.

Two recent examples where IPs have made successful applications to determine claims at an early stage are *AM Holdings* (see above) and *Fraser Turner Limited v. PwC and others* [2018] EWHC 1743 (Ch). In both cases, the court was prepared to deal with a short point of law or construction.

- In *AM Holdings*, the claim against the former administrators (for underselling certain properties) was stuck out on a point of law – namely that the applicable provisions of Guernsey law governing the administrators' discharge precluded further liability to the company for breach of duty.
- In *Fraser Turner*, the claim for unlawful means conspiracy was struck out as the court was able to determine a short point of contractual interpretation – namely, whether the contract (a royalty deed) contained certain express or implied terms. The court held that the contract did not contain the terms alleged by the claimant, so there was no breach of contract and no unlawful act, and the claim was therefore *'not maintainable'*.

Response two: play the long(er) game

Of course, an early application for strike out and/or summary judgment will not be an option in every case. Where there is no procedural or legal 'killer blow', and where the underlying evidence is contested and requires detailed analysis, then the claim is likely to proceed to trial.

Underselling claims, by their nature, are likely to involve contested factual and expert evidence about the sale process and asset value. They can be very difficult to strike out, leaving the IP with the prospect of defending years of litigation to clear their name – the case of Davey, which involved a two-year wait for judgment, being a good example of this.

Claims for unlawful means conspiracy are also difficult to dispose of early because the allegations are rarely based upon direct evidence of wrongdoing – rather they are based upon inferences made from certain key (and largely uncontested) facts, which may be open to a number of interpretations. It is more difficult to convince a court at an early stage that such claims are 'fanciful' or stand 'no real prospect of success', as the court is likely to want to see and hear all of the evidence before reaching a decision.

IPs therefore face a longer game to try to defeat these claims. Where an IP or firm is confident that the merits are in its favour, the best option is likely to involve a vigorous defence and waiting for the claimant to run out of steam (or funding), or ultimately, vindication from the court. *Premier Motor Auctions v.*

The traditional situation in which an IP becomes the target of litigation is where lenders have enforced personal guarantees against the company's directors or shareholders.

Lloyds Bank and PwC is a recent example of a case that failed to last the distance. The claim against both defendants for (*inter alia*) unlawful means conspiracy was dismissed (effectively dropped) just weeks before trial.

Tactics for IPs

Each case will require its own unique tactics and IPs will need to consider their options carefully and with close input from their legal advisers. However, other tactics IPs may wish to consider might include:

- Making early voluntary disclosure, especially where a claimant has pleaded a case 'pending disclosure', to demonstrate that there is nothing in the allegations and the claimant should abandon the case; and/or
- Making use of interim applications, such as security for costs, to protect their position and to increase the pressure on the claimants to obtain further funding and/or stronger ATE insurance. The *Premier* case is a recent example of a successful application by defendants for security for costs (see the Court of Appeal's decision at [2017] EWCA Civ 1872).

It is perhaps of little comfort but, where a claim that impugns the IP's integrity or professionalism fails, the IP can at least expect to recover indemnity costs. The case of *Two Right Feet Limited (In Liquidation) v. (1) National Westminster Bank PLC* (2) *Royal Bank of Scotland PLC (3) KPMG LLP [2017] EWHC 1745 (Ch)* (where the claim was abandoned after disclosure and the defendants were awarded indemnity costs) is a good example of this.

Where next?

It remains to be seen whether the high water mark for claims against IPs has been reached. None of the recent claims has resulted in a successful judgment for the claimants and some claims have been struck out at an early stage in proceedings.

Perhaps, as a simple matter of economics, the more of these claims that fail – whether in the initial stages, or just before trial – the less appetite funders and insurers will have to invest in similar litigation in the future.

In the light of the contentious nature of insolvency work and the evolution of the law (particularly around conspiracy), it seems inevitable that determined claimants will find new and ingenious ways to bring claims against IPs and their firms, as well as the means to fund them. For now, these claims pose a real threat, and one which practitioners will be keen to avoid.

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