European Perspective in Brief

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Europe has struggled mightily during the last several years to triage a long series of critical blows to the economies of the 27 countries that comprise the European Union, as well as the collective viability of eurozone economies. Here we provide a snapshot of some recent developments relating to insolvency and restructuring in the EU.

The U.K.—On May 9, 2013, the U.K. Supreme Court handed down its highly anticipated ruling in *BNY Corporate Trustee Services Limited v Eurosail and others* [2013] UKSC 28, in which the court for the first time interpreted the balance-sheet test for insolvency in section 123(2) of the Insolvency Act 1986. In its ruling, the Supreme Court also provided useful guidance concerning the correct application of the cash-flow test for insolvency in section 123(1)(e). These issues are highly significant, as "insolvency" must be proved for many purposes under English insolvency law.

The Supreme Court agreed with determinations by both the High Court and the Court of Appeal that Eurosail, a special-purpose securitization vehicle, was not balance sheet–insolvent. Even so, the Supreme Court's reasoning differed slightly from that of the lower courts. Key elements of the court's judgment include the following:

- The cash-flow test (i.e., whether a debtor can pay its liabilities as and when they fall due) not only considers debts presently due, but also can include liabilities

maturing in the "reasonably near future," depending on such factors as the nature of the company's business and whether it will continue trading. Consideration of liabilities accruing beyond the "reasonably near future" would require speculation, and in these circumstances, a comparison of present assets with present future liabilities (with adjustments for contingencies) might be the only sensible test for insolvency.

- The balance-sheet test requires the court to evaluate whether a company has sufficient assets to substantiate a reasonable expectation that it can expect to satisfy all of its liabilities, including prospective and contingent liabilities. This evaluation must be undertaken on the basis of available evidence and the particular circumstances of the case, with the caveat that relying on more distant liabilities (i.e., those which are not presently payable) will make the balance-sheet test for insolvency less easy to satisfy.

- The "point of no return" test adopted by the Court of Appeal as a formulation for the balance-sheet test for insolvency was rejected. The Supreme Court determined that the test interpreted the scope of the balance-sheet test too narrowly.

Europe, the U.S., and Canada—On May 7, 2013, the U.S. Bankruptcy Court for the District of Delaware denied a motion by European creditors of Nortel Networks Corp. ("Nortel") to certify a direct appeal to the U.S. Court of Appeals for the Third Circuit of the bankruptcy court's April 3, 2013, ruling (*In re Nortel Networks, Inc.*, Case No. 09-10138 (KG), 2013 BL 92666 (Bankr. D. Del. Apr. 3, 2013), denying a request to submit to arbitration a dispute over the allocation among creditors of $7.3 billion in cash raised in Nortel's liquidation. According to the court, the appeal was "frivolous" because "the agreement at issue plainly did not call for arbitration and . . . the circumstances dictate that the underlying dispute proceed" before it rather than an international arbitrator. By finding the appeal frivolous, the court defeated arguments that it lacked jurisdiction over the liquidation proceeds pending a ruling from the court of appeals.

In refusing to certify the appeal, the bankruptcy court sided with Nortel bondholders—principally U.S. hedge funds—and against advocates for Nortel's European creditors, a group that includes retirees and disabled former workers. Bondholders, whose claims are against Nortel U.S. and Nortel Canada, are seeking an expedited trial in the U.S. and Canada to decide the proper allocation of the liquidation proceeds. European creditors argue that international arbitration, with limited appellate rights, is the better and faster alternative for resolving the dispute. The decision means that Nortel's belligerent international creditors will likely join issue in a January 2014 trial. Nortel, the Toronto-based former technology icon, filed for bankruptcy protection in a number of countries in January 2009.

Nortel U.S. fired the first volley in the fray on May 14 when it filed objections in the U.S. bankruptcy court seeking to eradicate billions of dollars' worth of claims filed by European entities, contending that the parties are trying to appropriate funds which should rightfully go to creditors of the defunct telecom's U.S. unit. Nortel's British retirees responded on May 21 by asking the court to strike the objections, contending that they do not properly address any of the pension fund's allegations.

The U.K.—On March 27, 2013, the English High Court handed down a ruling in *In the Matter of Simon Carves Limited and In the Matter of the Insolvency Act 1986,* [2013] EWHC 685 (Ch), that illustrates the limitations of letters of support. In that case, Carillion Construction Limited ("CCL") sought leave to make an application under section 423 of the Insolvency Act 1986 (the "1986 Act") against Simon Carves Limited (in liquidation) ("SCL") and its ultimate parent company, Punj Lloyd Limited ("PLL"). CCL was an unsecured creditor of

SCL when SCL went into administration in 2011. After SCL entered administration, its business and assets were sold to a sister company by way of a prepackaged transaction. Unsecured creditors received a nominal dividend return.

By its application, CCL sought to compel PLL to honor three separate letters of support issued by PLL to CCL's board of directors from 2008 to 2010. It was partly on the basis of those letters that SCL continued to trade after March 2008 until July 7, 2011 (when the administration order was made), despite posting significant losses during that period. CCL claimed that the letters of support constituted enforceable obligations. It also claimed that the dividend payable to unsecured creditors was nominal only because the failure by SCL to enforce the letters of support diminished the proceeds available for distribution to SCL's creditors. According to CCL, the failure to enforce those obligations constituted a transaction defrauding creditors for the purposes of section 423 of the 1986 Act.

The court ruled that the letters of support were not binding on PLL. Because the letters of support issued by PLL were addressed to SCL's directors in connection with the preparation of annual accounts, the court explained, the letters were relevant only to enable the directors to consider whether it was appropriate for the financial statements for the year to be prepared on a going-concern basis. According to the court, there was no evidence that SCL and PLL had agreed that the letters would be binding. The court held that "the letters do not even purport to be a contract with SCL" and that "there is no indication in the letters of what the consideration was (if any) passing from SCL (or, for that matter, from the Board of Directors) in return for PLL's financial support." The court also found there was no agreement between SCL and PLL that the

letters of support would not be enforced, and so there was no "transaction" for the purposes of section 423 of the 1986 Act.

Other recent European developments can be tracked in Jones Day's *EuroResource*, available at http://www.jonesday.com/euroresource_may_2013.