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Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

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February-March 2024

Editor's Note: Dealing With Failure

By Victoria Prussen Spears*

When a business fails or an individual cannot meet his or her financial obligations, numerous difficult issues have to be handled. The articles in this issue of *Pratt's Journal of Bankruptcy Law* consider various of these issues, including from multiple jurisdictions.

A BANK FAILURE

The first article in this issue is titled, "Bank Failure Highlights Related Claim Issues, State Law Considerations, in Directors and Officers Insurance Claims." In this article, Geoffrey B. Fehling and Carleton Goss of Hunton Andrews Kurth review a recent federal court decision involving insurance coverage for claims stemming from the collapse of First NBC Bank.

RISK MANAGEMENT

The article that follows is titled, "Office of the Comptroller of the Currency Issues Guidance on Risk Management of 'Buy Now, Pay Later' Lending." Here, Amber A. Hay, Michael A. Mancusi, Kevin M. Toomey, Christopher L. Allen, Anthony Raglani and Michael Treves of Arnold & Porter Kaye Scholer LLP examine recent guidance issued by the Office of the Comptroller of the

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[*] Victoria Prussen Spears is a writer, editor, and law firm marketing consultant for Meyerowitz Communications Inc. A graduate of Sarah Lawrence College and Brooklyn Law School, Ms. Spears was an attorney at a leading New York City law firm before joining Meyerowitz Communications. Ms. Spears, who is Editor of *The Banking Law Journal*, *Pratt's Journal of Bankruptcy Law*, *Pratt's Energy Law Report*, *Pratt's Government Contracting Law Report* and *Pratt's Privacy & Cybersecurity Law Report*, published by Lexis, can be reached at vpspears@meyerowitzcommunications.com.

Currency on how national banks and federal savings associations can effectively manage risks associated with "buy now, pay later" lending.

IN LUXEMBOURG

Next, Jan Boeing, Geoffrey Delamarre and Tanner J. Wonnacott of K&L Gates LLP review Luxembourg's new insolvency law. Their article is titled, "Luxembourg Modernises Its Insolvency Legislation."

BRAZIL

We also have two articles about reorganizations in Brazil.

In the article titled, "The Recent Use of Brazilian Extrajudicial Reorganization Proceedings as a Successful Restructuring Tool," Francisco L. Cestero and João Guilherme Thiesi da Silva explores the implications of recent reforms on Brazilian extrajudicial reorganization proceedings, and why this route has become an attractive path for debtors.

Then, in "Investment Funds in Brazil: The 'New' Insolvency Regime and the Limitation of Liability of Investors," André M. Mileski and Pedro Rocha discuss a new resolution from the Brazilian Securities Commission that modernizes the regulatory framework for investment funds in Brazil.

NEGOTIATING

The second part of the three-part series, "Negotiations and The Art of Communicating," by Peter J. Winders, a shareholder and general counsel at Carlton Fields, P.A., is published here and continues the discussion of negotiating and communications – skills that every bankruptcy lawyer needs.

The first part, which was published in the January 2024 issue of *Pratt's Journal of Bankruptcy Law*, introduced the topic through engaging anecdotes, lessons and thoughts on listening and the gamesmanship of negotiations. This second part explains negotiating tactics in detail and mediation. The series will conclude in our next issue, when Mr. Winders examines humor in negotiations, and more.

Enjoy the issue!

Bank Failure Highlights Related Claim Issues, State Law Considerations, in Directors and Officers Insurance Claims

By Geoffrey B. Fehling and Carleton Goss*

In this article, the authors review a recent federal court decision involving insurance coverage for claims stemming from the collapse of First NBC Bank.

A Louisiana federal judge recently granted the motion for partial summary judgment filed by the Federal Deposit Insurance Corporation (FDIC) in a directors and officers (D&O) liability insurance coverage dispute involving "related" claims arising from the collapse of First NBC Bank. In addition to being a win for policyholders facing similar disputes involving related claims, the decision shows that related-claim issues depend heavily on both the specific policy language purchased and governing law. Here, the policyholder's victory turned largely on Louisiana law and the interpretation of the specific causation language used in the related claims and prior notice provisions. Shortly after the court's decision, the parties settled the dispute and dismissed the case.

BACKGROUND

The recent decision stems from the largest bank failure in Louisiana history. In 2017, First NBC Bank failed. The bank's failure triggered a series of legal actions, including a criminal action against the bank's former president and chief executive officer (CEO) that resulted in a 14-year prison sentence.[1]

At the time of its collapse, First NBC Bank had D&O insurance policies. This dispute pertained to the 2017 policies in place at the time the bank failed. The bank sought coverage for breach of fiduciary duty and gross negligence claims against executives in approving certain loans. The insurer denied coverage, arguing that the claims against executives were not "first made" during the policy period because the new claims related back to multiple claims and notices made or provided during the 2016 policy period. Coverage litigation ensued, and the FDIC, which had been appointed as receiver, and the 2017 insurers cross-moved for partial summary judgment.

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[*] The authors, partners in Hunton Andrews Kurth, may be contacted at gfehling@huntonak.com and cgoss@huntonak.com, respectively.

[1] https://www.justice.gov/usao-edla/pr/former-bank-president-ashton-ryan-sentenced-14-years-prison-fraud-ended-first-nbc-bank.

THE PRIOR MATTERS AND KEY POLICY PROVISIONS

According to the insurers, the claims against the executives were not covered under the 2017 policies because they were related to prior claims reported under earlier policies. Specifically, the insurers pointed to the following matters:

- An action by the Georgia insurance commissioner against First NBC and its CEO alleging that the bank was using straw entities to prop up an insurance company.
- Notice by a bank director of a potential claim identifying twelve borrowing relationships that could give rise to a lawsuit based on similarities to claims asserted in the Georgia action.
- A shareholder action against a bank holding company and its CEO and chief financial officer alleging securities violations by falsely portraying the company's finances.
- A shareholder derivative action against the directors and officers of the same bank holding company alleging that the defendants breached their fiduciary duties by misrepresenting the bank's financial situation.
- A prior joint examination by the FDIC (in its corporate capacity) and the Louisiana Office of Financial Institutions (LOFI) identifying problems with the bank's lending practices and non-compliance with laws and regulations and resulting in a consent order.

In support of their denial, the insurers relied on the policies' "Interrelationship of Claims" (IOC) provision and prior notice exclusion. The IOC provision stated that all claims "alleging, arising out of, based upon or attributable to the same facts, circumstances, situations, transactions or events" are considered a single claim first made at the time the earliest such claim was made. Because the 2017 policies were "claims-made" policies that provided insurance coverage only for claims made against insureds during the policy period, any claims that related back to claims first made under prior policy periods would not be covered.

The prior notice exclusion similarly barred coverage for claims arising out of the same facts that had been reported under a prior policy. The insurers argued that the prior notices of related claims barred coverage under the 2017 policies. Both provisions incorporated the same, broad "arising out of" causation language and involved analysis of the relationship between the current claim and prior claims.

THE DECISION

Following Louisiana law, the court began its analysis with the text of the policies. The parties agreed that the critical language in both provisions was "arising out of, based upon, or attributable to." The court acknowledged that this language "dictates how connected a claim must be to a previous claim in order to be excludable under these provisions." Unsurprisingly, the insurers urged the court to construe the language broadly – requiring only a "mere connection" with a prior claim. The court rejected that argument. Relying on the plain language and caselaw, it held that a "stronger relationship" was required. In reaching that conclusion, the court pointed out that the Louisiana Supreme Court defined "arising out of" to indicate a "but for" causal relationship without requiring a showing of direct or proximate causation.

Applying binding Louisiana law requiring the insurer to show a causal relationship, the court analyzed whether the FDIC's present claims arose out of prior claims. Ultimately, it determined that there was no indication that the present claims, which involved allegations of securities laws and breaches of fiduciary duties, were attributable to the same circumstances as prior claims. For instance, the court noted that the only similarity between the prior Georgia litigation and the present claims was that they involved the same bank, which did not meet the standard to establish relatedness. The director's notice of problematic borrowing relationships concerned only notice of potential claims, which cannot trigger either the prior notice exclusion or IOC provision.

The court further distinguished the two shareholder actions because they broadly related to financial misrepresentations and did not concern approval of specific loans like those at issue in the present claims. As a result, the actions did not amount to prior notice of the specific lending relationships at issue or show that those actions were interrelated with the specific lending relationships. The joint FDIC-LOFI matter did not support the insurers' denial because the consent order did not mention specific loan approvals. The fact that a matter had to do with lending was not by itself determinative.

Because none of the claims in the present dispute arise out of, were based upon, or were attributable to the matters identified in prior claims, the IOC provision and prior notice exclusion were not implicated. Thus, the Court granted the FDIC's partial summary judgment motion and rejected the insurers attempt to limit coverage.

CONCLUSION

This decision is notable for a few reasons.

First, the decision is significant because it underscores that related-claims analysis is highly fact-specific and turns on many factors, including the specific policy language, underlying allegations giving rise to the claims and losses, and applicable state law. Given all of these variables, there are often arguments both for and against relatedness, especially if a policy provision is written as broadly as those included in First NBC Bank's D&O policies. Policy forms vary widely and are often subject to negotiation, including with respect to exclusionary language that could support insurer defenses based on prior notices or claims.

Second, it highlights the importance of governing state law, which also varies significantly and can be dispositive on critical issues, like the proper interpretation of "arising out of" causation language. Policies may include choice-of-law or similar venue provisions that can impact this issue. Here, the decision was based on the interpretation of causation language under Louisiana law. Had Louisiana law supported a broader reading of those provisions like what was advocated for by the insurers, the court may have ruled that the claims were related and that there was no coverage.

Third, it is a reminder for banks to have a formal process for regularly reviewing their insurance coverages. The scope of such review should cover not only the amount and scope of coverage provided by each individual policy but also how policies fit together and operate within the overall insurance program, which can minimize coverage gaps and help avoid the risk of surprise denials should a claim arise. It is particularly important for banks that are in troubled condition, or that anticipate litigation, to (i) closely review the parameters of their insurance policies, and (ii) confer with counsel prior to filing a claim or responding to information requests from insurance companies.

Finally, the decision is a good reminder for policyholders to consider the effect of related-claim provisions in handling notices, claims, renewals, and other insurance decisions. Related-claim issues can arise from not only prior litigation, but also regulatory investigations, enforcement actions, consent orders, or notices of potential claims. Working with experienced brokers, coverage counsel, and other professionals can help policyholders understand the scope of related-claim provisions and how they work, which can help minimize any surprises should a claim arise. Further, understanding the effect of related-claim provisions can help with litigation strategy. Here, a month after the court's pro-policyholder decision on the related-claim provisions, the parties settled and the case was dismissed.

Office of the Comptroller of the Currency Issues Guidance on Risk Management of "Buy Now, Pay Later" Lending

By Amber A. Hay, Michael A. Mancusi, Kevin M. Toomey, Christopher L. Allen, Anthony Raglani and Michael Treves*

In this article, the authors examine recent guidance issued by the Office of the Comptroller of the Currency on how national banks and federal savings associations can effectively manage risks associated with "buy now, pay later" lending.

The Office of the Comptroller of the Currency (OCC) has issued Bulletin 2023-37 (the Bulletin),[1] providing guidance to national banks and federal savings associations on how to effectively manage risks associated with "buy now, pay later" (BNPL) lending. Specifically, the Bulletin addresses BNPL loans that are payable in four or fewer installments and carry no finance charges. BNPL loans, also referred to as "point-of-sale installment loans" or "pay-in-4" loans, have grown in popularity in recent years, particularly among younger consumers and consumers with limited or no credit history.

The Bulletin follows the Bureau of Consumer Financial Protection's (CFPB) September 2022 report[2] on market trends and consumer impacts of BNPL, its March 2023 report[3] on consumer use of BNPL, and the Federal Reserve Bank of New York's September 2023 study[4] on the users of BNPL. These reports indicated that borrowers with lower credit scores, greater unmet credit needs, and greater financial fragility make up a disproportionate share of all BNPL users and identified several areas of potential consumer harm associated with BNPL lending, including inconsistent consumer protections, such as lack of standardized disclosures, divergent approaches on late fees and consumer fees as a whole, and data-harvesting, and the risk of excessive debt accumulation and overextension.

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* The authors, attorneys with Arnold & Porter Kaye Scholer LLP, may be contacted at amber.hay@arnoldporter.com, michael.mancusi@arnoldporter.com, kevin.toomey@arnoldporter.com, christopher.allen@arnoldporter.com, anthony.raglani@arnoldporter.com and michael.treves@arnoldporter.com, respectively.

[1] https://www.occ.gov/news-issuances/bulletins/2023/bulletin-2023-37.html.

[2] https://files.consumerfinance.gov/f/documents/cfpb_buy-now-pay-later-market-trends-consumer-impacts_report_2022-09.pdf.

[3] https://files.consumerfinance.gov/f/documents/cfpb_consumer-use-of-buy-now-pay-later_2023-03.pdf.

[4] https://libertystreeteconomics.newyorkfed.org/2023/09/who-uses-buy-now-pay-later/.

BACKGROUND

In a typical BNPL transaction, the lender pays the merchant for the good or service and takes on the responsibility of granting credit and collecting payments from the borrower. To compensate for the risk of default by the borrower, the merchant charges the lender a discounted amount of the full purchase price of the good or service. The lender then collects the full purchase price through installment payments from the borrower. If the borrower does not pay on time, the lender may charge late fees and refuse to make additional BNPL loans to the borrower until the borrower brings the account current.

MANAGING RISKS ASSOCIATED WITH BNPL LENDING

While the OCC acknowledges in the Bulletin that, when used responsibly and offered in a transparent manner, BNPL loans can support consumers' overall financial capabilities by providing a convenient and relatively low-cost financing alternative, the OCC believes that BNPL lending nevertheless carries risks for both consumers and banks. The Bulletin identifies several types of risks banks face through BNPL loans and provides recommendations to mitigate those risk, including:

- *Credit Risk*: The Bulletin explains that BNPL loans are typically approved using soft credit bureau inquiries and that BNPL loans are not yet included in reporting by the three major credit bureaus. As a result, banks may have limited visibility into applicants' activities on other platforms and limited insight on a borrower's risk of default. Borrowers may also overextend themselves or may not fully understand BNPL loan repayment obligations. To address issues with credit bureau reporting, the OCC encourages banks to furnish comprehensive information on BNPL loans to the credit reporting bureaus in a timely manner. The Bulletin also suggests that banks establish policies and procedures for BNPL lending that address loan terms, underwriting criteria, and methodologies to assess repayment capacity, fees, charge-offs, and credit loss allowance considerations. The OCC notes that BNPL loans create unique challenges for credit underwriting and repayment assessment methodologies. Repayment assessment methodologies may include assessing debt-to-income, debt-to-assets, or residual income; using deposit account information; or using alternative data. An example of a credit risk management strategy is lower lending caps for new or higher-risk borrowers that gradually increase as the borrower exhibits positive repayment behavior. The OCC further indicates that methods to collect BNPL debt, mitigate losses, and contact borrowers may require specialized approaches and strategies that differ from traditional consumer debt collection practices.

- *Operational Risk*: The Bulletin refers to the highly automated nature of BNPL lending and observes that, with rapid credit decisions and frequent strong reliance on third parties, BNPL lending may present elevated operational risk, specifically including fraud risk and risks associated with model use. The OCC identifies that merchant returns and disputes are a common consumer complaint, and that banks should have processes for handling merchant returns and disputes that are fair to consumers and match disclosures provided to consumers. The Bulletin discusses steps that banks should take to address fraud risk, including implementing processes to confirm that potential borrowers are of legal age to obtain credit (particularly for online transactions); adopting procedures to address first payment default; and developing controls to promptly identify suspected fraud, take steps to mitigate loss, and recognize charge-offs in a timely manner. The Bulletin also advises that models used in the BNPL lending process (e.g., models used in marketing, credit decision making, customer service, or fraud risk management) should be subject to sound model risk management and incorporated into a bank's model risk management processes.
- *Compliance Risk*: The Bulletin indicates that banks could be at risk of violating prohibitions on unfair, deceptive, or abusive acts or practices due to the lack of clear, standardized disclosure language. Borrowers may also overextend themselves and, with loan payments typically tied to a debit or credit card, overextension can result in secondary fees charged to the borrower, such as overdraft, non-sufficient funds, and late fees. The Bulletin provides that banks should pay close attention to marketing, advertising, and consumer disclosures to ensure that they clearly state the borrower's obligations and any fees that may apply. The OCC also expects banks to consider the applicability of specific federal consumer protection laws and regulations to the bank's particular BNPL lending practices.
- *Third-Party Risk*: The Bulletin notes that banks that provide BNPL loans through a merchant or a third-party intermediary BNPL provider should have effective risk management processes to manage the risks from third-party relationships. Third-party relationships may increase a bank's exposure to operational and compliance risks because the bank may not have direct control of the activity performed by the third party. The Bulletin provides that banks that partner with third-parties to offer

BNPL loans should incorporate that relationship into the bank's third-party risk management processes.

CONCLUSION

The Bulletin outlines the OCC's expectations for national banks and federal savings associations that engage in BNPL lending. On the one hand, the Bulletin highlights certain consumer needs that potentially may be served by BNPL lending. However, on the other hand, the Bulletin reflects a recognition by the OCC of the unique characteristics and risks of BNPL loans – in particular, its high automation, reduced borrower information, and reliance on third-parties – and that banks seeking to engage in this lending activity may be required to implement new, specialized risk management approaches that differ from traditional practices.

Third-party risk continues to be a top concern of the federal banking agencies. BNPL merchants and intermediary third-parties may present increased compliance risks due to their unfamiliarity with banking regulations. Banks should consider enhancing their oversight of BNPL partners and reviewing third-party risk management controls, particularly for underwriting standards, repayment and fee practices, processes for handling merchant returns and disputes, as well as marketing and disclosures.

In addition, the OCC expects banks to do their part to improve credit reporting of BNPL loans. The reporting of BNPL loans to credit bureaus will create operational and compliance risks with respect to reporting data correctly. As the three major credit bureaus get ready to include BNPL transactions in their reporting, banks should review and, if necessary, update their credit reporting policies and practices to account for the unique characteristics of BNPL loans. In the meantime, banks should consider some of the recommended methods identified in the Bulletin to avoid borrower overextension and reduce credit risk in the absence of full credit information at the time the loans are approved.

Lastly, given the recent attention of the CFPB on BNPL loans and the emphasis on consumer protection throughout the Bulletin, it would be to the benefit of banks and other BNPL providers to ensure that their BNPL lending practices align with traditional lending laws and regulations.

Luxembourg Modernises Its Insolvency Legislation

By Jan Boeing, Geoffrey Delamarre and Tanner J. Wonnacott*

In this article, the authors review Luxembourg's new insolvency law.

The parliament of the Grand Duchy of Luxembourg (Luxembourg) has passed bill no. 6539A into law (the New Insolvency Law), marking a significant milestone in the movement to modernise and enhance the competitiveness of Luxembourg's insolvency framework. The bill has been under discussion for a number of years and aims to curtail the use of bankruptcy as an insolvency solution in favour of the preemptive preservation or reorganisation of financially distressed companies. It implements Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks into national law.

The New Insolvency Law has come into force on November 1, 2023, and introduces novel preventative options for financially distressed companies, both in and out of court, for the avoidance of bankruptcy.

Further, the New Insolvency Law discards several facets of the Luxembourg insolvency framework, which had become seldom used and commonly regarded as obsolete, thereby effecting a broader reform of the framework.

SCOPE

In-Scope Entities

The New Insolvency Law applies to the following entities:

- Commercial company types with legal personality including, among others:
  - (i) Public companies limited by shares (*société anonyme*);
  - (ii) Corporate partnerships limited by shares (*société en commandite par actions*);
  - (iii) Private limited liability companies (*société à responsabilité limitée*); and

* Dr. Jan Boeing is a partner and head of the banking and finance practice of K&L Gates LLP's Luxembourg office. Geoffrey Delamarre is a counsel in the Asset Management and Investment Funds practice of the firm's Luxembourg office and specializes in private equity and mergers and acquisitions. Tanner J. Wonnacott is an associate at the firm.

   (iv) Common limited partnerships (*société en commandite simple*); and

- Special limited partnerships (*société en commandite spéciale*), akin to the LLP used under common law.

Out-of-Scope Entities

The New Insolvency Law does not impact regulated entities subject to special insolvency regimes, including, in particular:

- Credit institutions and investment firms;
- Insurance and reinsurance undertakings;
- Payment institutions and electronic money institutions;
- Securitization undertakings issuing financial instruments to the public on a continuous basis; or
- Investment funds (e.g., UCITs, SICARs, RAIFs, SIFs).

OUT-OF-COURT REORGANISATION BY MUTUAL AGREEMENT

Under the New Insolvency Law, a distressed company may, on a voluntary basis, request the appointment of a conciliator (*conciliateur d'enterprise*) named by the minister for the economy or the minister for small and medium-sized enterprises (depending on their competency) for the purpose of facilitating the conclusion of an amicable reorganisation of some or all of the company's assets or businesses with either all of its creditors or at least two of them (an Amicable Agreement).

If an Amicable Agreement is reached, the distressed company may apply for the agreement's certification by the district court sitting in commercial matters (*Tribunal d'arrondissement siégeant en matière commerciale*). Such certification will grant an enforceable character to the Amicable Agreement and make any transactions contemplated by the Amicable Agreement unavoidable, even if they fall – should the distressed company ultimately file for bankruptcy – within the suspect period (that is, the period between the actual date of cessation of payments[1] and the starting date of any eventual bankruptcy proceeding). Prior to the court's certification of an Amicable Agreement, it will verify that the purpose of that Amicable Agreement is indeed to reorganise all or part of the distressed company's assets or activities. A certified Amical

[1] As a general rule, this date may be no more than six months prior to the opening of bankruptcy proceedings.

Agreement is neither subject to publication or notification nor is it, as an out-of-court agreement, subject to appeal.

The instrument of an Amicable Agreement can provide a forum for confidential negotiations between the debtor and its creditors and prepare a pre-negotiated plan of reorganisation. Even if no consensus is reached, this process can help to build the majority required to achieve a court-recognised collective agreement.

JUDICIAL BANKRUPTCY PREVENTION PROCEDURES

As an alternative to the out-of-court reorganisation, a distressed company may seek to preserve the continuity of all or part of its assets or activities under the supervision of the court via a new toolkit of judicial reorganisation proceedings. These tools consist of:

- A Court-Recognised Collective Agreement

  A distressed company may wish to reach a collective agreement (*accord collectif*) with some or all of its creditors on a reorganisation plan. A reorganisation plan that properly depicts the company's current financial situation and lays out its proposed solutions may be submitted to the court for judicial recognition. Participation in this process is limited to ordinary and extraordinary creditors[2] whose rights are implicated by the considered plan.

  Approval of a reorganisation plan is required from a majority of the participating creditors of each class who represent at least half of the sums owed in each class. A mechanism has nevertheless been introduced for approval of the plan by the court despite failure to receive acceptance from a majority of creditors: a reorganisation plan may be approved by the court if:

  The plan has been approved by at least one class of creditors entitled to participate;

  No class is entitled to receive or keep more than the total amount of its claims; and

[2] The New Insolvency Law distinguishes between "ordinary creditors" (*créanciers sursitaires 'ordinaires'*) and "extraordinary creditors" (*créanciers sursitaires 'extraordinaires'*)for the purposes of a court-recognized collective agreement, extraordinary creditors consisting of those holding extraordinary claims, i.e., claims secured by special leins or mortgages, the claims of creditor-owners, and the outstanding claims of tax and social security authorities, while ordinary creditors are those holding ordinary claims, which are simply claims not qualifying as extraordinary claims.

In the case of approval by ordinary creditors only, the plan is built to ensure the favourable treatment of extraordinary creditors.

An approved reorganisation plan, which must be implemented within five years of its approval, will bind all affected creditors, including any dissenting creditors, and the full scope of the debtor's liabilities covered by the plan will be considered fulfilled upon the plan's completion. Even after approval, however, a reorganisation plan may be revoked upon a debtor's declaration of bankruptcy, or at the request of a creditor who has suffered prejudice as the result of the debtor's demonstrable inability to implement the plan. Revocation, though nullifying any future effect of the plan, does not affect the plan's validity concerning payments and transactions already carried out pursuant thereto.

Finally, the creation of a collective agreement on a reorganisation plan is underpinned by a key guiding principle: no creditor should be disadvantaged by the approval of a plan, as opposed to the creditor's treatment in the event that the plan had been rejected and the normal sequence of events (i.e., bankruptcy or compelled liquidation) had played out.

- A Court-Ordered Stay Of Payments

As a distressed company pursues a solution to its financial situation, whether in court or through extrajudicial Amicable Agreement, it may petition the court for a temporary stay (*sursis*) of payments on its debts to buy time for the negotiations of an Amicable Agreement. A temporary stay of this kind may not exceed an initial term of four months (which can be extended to a maximum of 12 months). During the term of the stay of payments:

(i) The debtor may not be declared bankrupt, other than at the debtor's election;

(ii) The movable and immovable assets of the debtor (subject to some exceptions, as is discussed in Section 4 below) are exempted from any enforcement action; and

(iii) The debtor's ongoing contracts are unaffected.

An approved stay of payments affords the debtor the opportunity (and obligation) to prepare for its future viability by preparing a restructuring plan which must include descriptive, prescriptive, and operative elements.

Upon court approval of a stay of payments, the debtor may unilaterally decide to suspend the performance of its contractual obligations during the term of the stay, though (i) the parties with which the debtor has contracted are entitled to the same right, and (ii) the stay does not extend to claims arising from services performed during the stay under ongoing contracts. During the term of the stay, payments from third parties which are required for the continuation of the debtor's business will remain effective.

- A Court-Ordered Transfer of Assets

  At a distressed company's election or by the initiative of the public prosecutor,[3] the court may be petitioned to order the transfer of some or all of the distressed company's assets. The transfer process is overseen by a court-appointed legal representative, who either (i) effectuates the sale or transfer of assets, both movable and immovable, necessary or useful to carry out all or part of the debtor's business by seeking offers from third-party buyers, either publicly or by mutual agreement, or (ii) by seeking offers for a merger. In either event, the legal representative is responsible for presenting the distressed company and the court with the offers received. Judicial approval of the legal representative's selected offer must be granted before the transfer may take place.

  A debtor seeking to avail itself of one of these tools has to submit a petition to the court:

  (i) Describing the facts on which the request is made and upon which, in the company's view, the continuity of its business is threatened;

  (ii) Indicating the objective(s) for which it requests the initiation of the given procedure; and

  (iii) Providing a list of documentation required for the application's assessment[4] or, in the case that any requested documents

[3] Prosecutor is responsible for prosecuting criminal cases and representing the interests of society in litigation.

[4] This documentation is to comprise:
(i) The last two approved annual accounts or the last two personal income tax returns (in the case of natural persons);
(ii) A statement of assets and liabilities and an income statement, each no more than three months old;
(iii) A budget containing an estimate of income and expenditure during the expected timespan of the proceedings;

cannot be provided, a note giving detailed reasons for the impossibility.

While an application for any of the forms of judicial reorganisation is pending, the debtor may not be declared bankrupt nor be judicially dissolved. Finally, no realisation of property, movable or immovable, may take place before the court has ruled on any such petition.

It should be noted that the New Insolvency Law provides for a high level of flexibility in the employment of these proceedings, permitting them to be applied for and eventually employed according to varying strategies for each of a company's businesses or parts of businesses, as well as to petition the court, at any point during a temporary stay of payments, for a change in the objective of the judicial reorganisation procedure.

NO IMPACT ON FINANCIAL COLLATERAL ARRANGEMENTS AND PROFESSIONAL PAYMENT GUARANTEES

The law of August 5, 2005, on financial collateral arrangements, as amended, and the law of July 10, 2020, on professional payment guarantees have positioned Luxembourg as an attractive and creditor-friendly jurisdiction for cross-border transactions.

Financial collateral arrangements (such as pledge agreements or netting arrangements) have always been unaffected by any kind of (national or foreign) insolvency proceedings. Likewise, unless agreed otherwise between the parties, a professional payment guarantee remains in place, despite any kind of (national or foreign) insolvency proceedings opened against the debtor in favour of which the payment guarantee is given.

The New Insolvency Law maintains the safe-harbour rules for financial collateral arrangements and professional payment guarantees so that no procedure under the New Insolvency Law affects in any way the validity or

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(iv) A complete list of the company's creditors and of the assets subject to security interest or mortgage or owned by a creditor;
(v) A statement of the measures and proposals under consideration for restoring the company's profitability/solvency and satisfying creditors;
(vi) A description of the manner in which the company has fulfilled its legal and contractual obligations to inform and consult employees or their representatives;
(vii) In the case that the company requests suspension of any seizure and sale of immovable property, a copy of the relevant order(s)/writ(s); and
(viii) In the case that the company is a legal entity with at least one partner characterized by unlimited liability, with proof that any such partner has been informed.

enforceability of a financial collateral arrangement or a professional payment guarantee. In particular, a court-ordered temporary stay of payments (as described above) does not prevent a creditor from the enforcement of a financial collateral arrangement governed by Luxembourg law.

To the contrary, other security interests, e.g., pledges which do not constitute financial collateral arrangements and mortgages granted by the debtor will generally be unenforceable through any temporary stay of payments.

INNOVATIONS FOR THE EARLY DETECTION OF FINANCIAL DIFFICULTIES

Endowing the measures introduced by the New Insolvency Law with the greatest preventative effect requires the timely identification of companies having a heightened risk of insolvency. To that end, the New Insolvency Law tasks the minister of the economy and the minister for small and medium-sized enterprises with the collection of information, specific to their respective spheres of responsibility, to be used in the detection of companies in financial difficulties whose likelihood of continuity is doubtful.

To make use of this information for early warning purposes, the New Insolvency Law conceives of a special Evaluation Committee for Businesses in Difficulties (*Cellule d'évaluation des entreprises en difficulté*) which will be comprised of five members designated by the minister of the economy from among the ranks of the VAT Authority (*Administration de l'Enregistrement et des Domaines*), the Direct Tax Administration (*Administration des Contributions Directes*), the Social Security Authority (*Centre Commun de la Sécurité Sociale*) and other main public administrators (the Special Committee).

To aid in the detection of debtors in financial difficulties, the Special Committee is equipped to review:

- A list of debtors who, under certain circumstances, have failed to pay all their social security and VAT obligations;
- Notifications of redundancies for economic reasons;
- Information stored at the National Institute of Statistics and Economic Studies (STATEC);
- The *tableau des protêts* prepared by the registrars (*receveurs de l'enregistrement*); and
- Certain judgments against the debtor.

The Special Committee, whose details of operation will ultimately be set down and governed by a Grand-Ducal Regulation, will serve to assess the appropriateness for an in-scope entity to file for bankruptcy.

STRONGER CHECKS AGAINST ABUSES OF THE BANKRUPTCY FRAMEWORK

The New Insolvency Law amends the bankruptcy provisions of the Luxembourg commercial code and the Luxembourg criminal code with a view towards stronger deterrence of fraudulent bankruptcy filings (*banqueroute frauduleuse*).

First, fraudulent bankruptcy is reclassified from its former status as a crime to an offence (*délit*), which, despite at first glance signalling softness on bankruptcy fraud, is ultimately intended to streamline the prosecution of such incidents.

Second, the scope of the offence of fraudulent bankruptcy (as well as the benign simple bankruptcy (*banqueroute simple*) is now broadened to cover not only the debtor's directors but also its de facto directors.

ANCILLARY REFORM

The New Insolvency Law introduces additional regulations to implement the New Insolvency Law's preventative measures into practice, namely the suspension of the statutory obligation for a distressed company to voluntarily file for bankruptcy,[5] along with the suspension of any realisation of assets pursuant to any general enforcement measure (*voie d'exécution*), from the time of the company's application for a judicial reorganisation up to a point in time determined by the court on a case-by-case basis, along with the empowerment of the public prosecutor to initiate bankruptcy proceedings.

Finally, to declutter Luxembourg's insolvency prevention toolkit, the New Insolvency Law marks the formal repeal of several related proceedings (except for the ongoing proceedings) – composition with creditors (*concordat préventif de la faillite*) and controlled management (*gestion contrôlée*) – which have rarely, if ever, been utilised in practice.

CONCLUSION

Similar to the United States with its Chapter 11 proceedings and the United Kingdom with its restructuring schemes, Luxembourg has now reformed and revamped the range of options available to debtors in financially distressed situations and provides viable alternatives to a bankruptcy.

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[5] The 30 days deadline to file for bankruptcy once the two cumulative conditions of cessation of payments and loss of creditworthiness are met is suspended as long as the judicial reorganisation is ongoing.

Luxembourg thereby joins other EU member states, such as Germany with its so-called StaRUG proceedings,[6] having recently modernised their bankruptcy law framework.

While it remains to be seen to what extent the new toolbox introduced by the New Insolvency Law will be used by the players in the Luxembourg economy, the New Insolvency Law is a welcome and much sought-after development, which should enable Luxembourg to increase its attractiveness for restructurings in a number of different scenarios and should preserve the popularity of the double Luxco structure.

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6 *Unternehmensstabilisierungs- und -restrukturierungsgesetz* of 22 Dezember 2020 (BGBl. I S. 3256), as amended.

The Recent Use of Brazilian Extrajudicial Reorganization Proceedings as a Successful Restructuring Tool

By Francisco L. Cestero and João Guilherme Thiesi da Silva*

In this article, the authors explore the implications of recent reforms on Brazilian extrajudicial reorganization proceedings, and why this route has become an attractive path for debtors.

Five years ago, Brazilian extrajudicial reorganization proceedings (*recuperação extrajudicial*, or EJ) were seen as an innovative legal tool to restructure U.S. dollar denominated debt issued or guaranteed by Brazilian debtors. In 2017, the restructuring of Odebrecht Oil & Gas marked the first successful large case that used an EJ to implement the restructuring of New York law-governed notes.[1] Since then, and particularly after 2021 when new changes to the law were introduced, the EJ has been increasingly used to implement debt restructurings due to its numerous advantages.[2]

This article explores the implications of these reforms on Brazilian extrajudicial reorganization proceedings, and why this route has become an attractive path for debtors.

OVERVIEW OF EJ PROCEEDINGS

In an EJ process, the debtor negotiates the restructuring terms with its creditors prior to filing an EJ with the court.[3] The terms of the restructuring are documented in a plan of extrajudicial reorganization (the EJ Plan). The EJ Plan is usually submitted by the debtor to the EJ Court for confirmation once the plan is approved by creditors holding at least more than half of the claims (in

[*] Francisco L. Cestero, a partner in the São Paulo office of Cleary Gottlieb Steen & Hamilton LLP, may be contacted at fcestero@cgsh.com. João Guilherme Thiesi da Silva, an associate in the São Paulo office of Pinheiro Neto Advogados, may be contacted at jgsilva@pn.com.br. Attorneys affiliated with Cleary Gottlieb do not practice Brazilian law. Any views expressed herein are not and should not be construed as legal advice and should be discussed with Brazilian counsel.

[1] See Odebrecht Oil & Gas and the Use of Brazilian Extrajudicial Reorganization in Cross-Border Restructurings, 14 Pratt's Journal of Bankruptcy Law 328 (2018).

[2] The authors' firms have represented the debtor or the main group of creditors in all the relevant restructurings of New York law bonds under Brazilian EJs since 2017.

[3] In an EJ process, venue should be where the debtor's principal establishment is located. In a large number of cases, that concept is generally applied similarly to the center of main interest as in other jurisdictions.

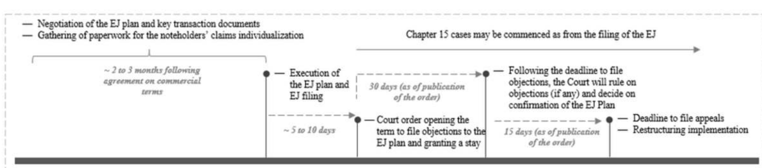
value) of each class of creditors impaired by the EJ Plan. Debtors are generally free to only include specified classes of similarly situated creditors in the EJ Plan and leave the remaining creditors unimpaired, allowing the debtor to manage the plan's impact on suppliers, customers, and other stakeholders. An EJ Plan, however, is not available to impair labor claims, contingent claims, claims deriving from aircraft leases, and tax claims.

At the time of the EJ filing, the debtor may request either:

(i) Confirmation of the EJ Plan; or

(ii) That the Court grant a 90-day stay period for the debtor to seek the EJ requisite majority threshold, provided that at the EJ filing the creditors holding at least one third of the claims (in value) of each impaired class have given their prior consent to the EJ Plan.

At the time of filing, the debtor is provided with a stay of enforcement actions and lawsuits for a period of 180 days. Once the debtor requests confirmation of the EJ Plan, impaired creditors have 30 days to file objections to the EJ Plan based on an exhaustive list of potential challenges, after which the court is expected to enter an order deciding on the EJ Plan confirmation.



Since January 2021, changes to the Brazilian Bankruptcy Code have increased the attractiveness of the EJ as a restructuring tool by decreasing the required majority for approval, statutorily providing for a stay period, contemplating mechanics for the restructuring of tax claims in direct negotiations with the authorities, and giving legal certainty to the effectiveness of collateral granted during EJ proceedings. Some of these points, and more, are discussed below.

WHAT MAKES EJ PROCEEDINGS SO ATTRACTIVE?

Acceptance Threshold and Consent Process

While confirmation of an EJ Plan requires the consent of creditors holding at least half of claims (in value) of each class impaired by the EJ Plan, there is no requirement on headcount. This requisite majority threshold came into effect in 2021 as part of a reform of the Brazilian Bankruptcy Code, and replaced existing rules which required a consent threshold of more than 60% of claims (in value). The EJ proceedings do not provide for cross-class cramdown, given that each class of creditors must approve its plan. Multiple plans may be filed as part of the same EJ proceeding to restructure different classes of creditors.

This simple majority consent threshold in EJ proceedings is highly attractive if compared to alternative foreign or local restructuring processes, and to the threshold required for contractual amendments of debt documents outside of an insolvency process.[4]

The negotiations over an EJ Plan often take place privately and, typically, creditors evidence their approval of an EJ Plan by signing the plan that is submitted to the court. However, this may not always be the case where the impaired debt is publicly traded and the holders of claims are pulverized.

In the EJ proceedings of Odebrecht Engineering and Construction (OEC), which was used to restructure seven series of its New York law-governed notes, the debtor launched a consent solicitation process to get the noteholders' approval to the EJ Plan and ensuing exchange of their notes. Through this mechanism, the OEC EJ Plan obtained the support of approximately 73% of the principal amount of its old notes.[5] Recent amendments to the law now allow for filing with the support of one third of the claims in value (with a 90-day period to obtain the remainder support for approval of an EJ Plan), but this mechanism has not been used to date.

Fast-Track Process

EJ proceedings are often faster and less expensive than many other court-run restructuring processes, either in Brazil or in foreign jurisdictions. It typically takes between two to six months to move from an EJ filing to the court confirmation of the EJ Plan,[6] depending on the venue, the court's workload and any litigation. Following the court's confirmation of the EJ Plan, the debtor and

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[4] Typical notes indentures governed by New York law do not permit reductions of the principal amount of the notes and changes to interest rates, unless 100% of the outstanding principal amount of notes consents to such amendments (which is practically impossible).

[5] The authors' firms represented Odebrecht Engineering and Construction as international counsel in its EJ proceedings.

[6] A report analyzing the EJs filed in 2021 has found that courts take 162 days on average to enter a confirmation order in EJ proceedings. Specifically with respect to EJs filed in Sao Paulo and Rio de Janeiro, courts took 127 and 70 days, respectively, to enter a confirmation order. See OBRE – Observatorio Nacional de Recuperacao Extrajudicial, Fase 2: https://www.observatoriorextra.com.br/.

creditors are expected to work on completion of the restructuring transaction, pursuant to the terms and deadlines set forth in the EJ Plan, and the duration of the EJ Plan's implementation may vary according to the particularities of each case.

Debtor	*Filing Date*	*Confirmation Date*	*Court*	*Length of Proceedings (From Filing Until EJ Plan Confirmation)*
Odebrecht Oil & Gas	May 23, 2017	October 19, 2017	4th Commercial Court of the Judicial District of Rio de Janeiro	Four months and 26 days
Odebrecht Engineering and Construction	August 20, 2020[7]	October 26, 2020	1st Bankruptcy Court of the Judicial District of Sao Paulo	Two months and six days
Andrade Gutierrez	September 29, 2022	November 29, 2022	1st Corporate Court of the Judicial District of Belo Horizonte	Two months
Ocyan	December 12, 2022	March 20, 2023	4th Commercial Court of the Judicial District of Rio de Janeiro	Three months and eight days[8]

EJs give contesting creditors limited ability to raise objections to the EJ Plan. Once the court receives an approved EJ Plan, it orders the publication of a notice opening a 30-day window for creditors to file potential objections. The law limits the nature of possible objections to a defined list, including:

(i) A failure to comply with the required consent threshold;

[7] Before filing for EJ, Odebrecht Engineering and Construction launched a consent solicitation process to get the creditors' required consent to the EJ Plan. The consent solicitation process spanned one month and a half (from June 15, 2020 through July 31, 2020).

[8] Courts in Brazil are in recess between December 20 and January 20 of each year. During this period, procedural terms to comply with court deadlines are generally stayed and Judges may not be available to enter orders in the regular course of EJ proceedings, which was the case in Ocyan's EJ proceedings.

(ii) Fraudulent transfers; and

(iii) A breach of any other legal requirements.

Following that 30-day period, the court opens a five-day window for the debtor to respond to objections (if any), after which the court is expected to decide on the EJ Plan confirmation.

The confirmation order may be subject to appeal, however the filing of appeals does not have any automatic suspensory or injunction effects, unless otherwise ordered by the court of appeals in case of irreparable harm and likelihood of success on the merits.

Growing Number of Precedents and Developing Case Law

The growing number of EJs that have been filed over recent years has provided debtors, creditors (including foreign entities and investors), judges, and practitioners with a deeper knowledge and higher degree of confidence and predictability on the EJ process. Although many questions on EJs remain open and untested, such as the scope and limits of class composition (e.g., impairment of similarly situated creditors in a single class for voting purposes, but not identically positioned in the debtor's capital structure), many other open points have been tested and decided by the courts, including the possibility to use a variety of restructuring tools. The predictability of the restructuring process tends to be higher in cases where the EJ is filed with specialized bankruptcy courts, such as the Sao Paulo and the Rio de Janeiro district courts.

Variety of Restructuring Options and Components

EJ proceedings give the debtor and creditors flexibility to choose among various restructuring options in exchange for the cancellation of their existing claims, such as the conversion of debt into equity, the issuance of new debt, participatory or convertible instruments, and corporate governance protections. In many instances, to address different interests from the creditor group, EJ Plans provide a menu of restructuring options to choose through an election process that is launched after the entry of the EJ Plan confirmation order. For example, participatory instruments or convertible notes may be issued in lieu of equity for creditors who have restrictions on holding equity but wish to benefit from equity upside.

Debtor	*Amount of Debt Restructured*	*Nature of Restructured Debt*	*Restructuring Components*
Odebrecht Oil & Gas	$5Bn	New York law governed, dollar denominated notes	• New secured notes • Participatory debt instrument
Odebrecht Engineering and Construction	$3.4Bn	New York law governed, dollar denominated notes	• New notes • Participatory debt instrument • Corporate governance protections
Andrade Gutierrez	$525Mn	New York law governed, dollar denominated notes	• New secured notes
Ocyan	$2.7Bn	New York law governed, dollar denominated notes	• New secured notes • Convertible notes • Carve out – new equity • New money • Corporate governance protections

Debtor in Possession Financing

Although the administrative super-priority status for DIP financings is not explicitly contemplated under law for EJ proceedings, EJ Plans may include the provision of new money by existing creditors or third party lenders, who can often obtain significant protections.[9] In this case, the EJ Plan would provide for the terms and conditions of the DIP loan, including the scope and nature of any collateral, which can be in the form of fiduciary liens.[10] The 2021 reforms to the Brazilian Bankruptcy Code included a new protection to DIP lenders, whereby the granting of collateral to good-faith DIP lenders shall not be overruled or reversed following the completion of the DIP transaction or the transfer of the DIP loan, provided that such a transaction has been set forth in the EJ Plan or confirmed by the bankruptcy court.

[9] Existing creditors that provide new money are entitled to receive differential treatment for their claims.

[10] Fiduciary lien is a type of security under Brazilian law pursuant to which the ownership of the collateral is transferred to the secured party as of its perfection, while the borrower remains in the possession of the asset. Claims secured by fiduciary liens (up to the value of the collateral) are not subject to Brazilian court-run restructuring processes (*recuperação judicial and EJs*).

Availability of Chapter 15 Recognition

Similar to Brazilian judicial reorganization proceedings (*recuperacao judicial*), U.S. Bankruptcy Courts have granted recognition to EJs and have enforced EJ Plans in Chapter 15 proceedings. Debtors may seek a recognition order at the EJ filing and an enforcement order later, upon confirmation of the EJ Plan by the Brazilian court. Alternatively, they may seek recognition of the EJ as a foreign main proceeding and enforcement of the EJ Plan at the same time, following the Brazilian court's confirmation order. EJs have been recognized and enforced in the Chapter 15 cases of Odebrecht Oil & Gas, Odebrecht Engineering and Construction, Andrade Gutierrez, and Ocyan.

EJS ENDURING POPULARITY

Not long ago, EJs provided debtors and creditors with limited predictability over the restructuring process due to its innovative aspect. Today, the growing number of filings, coupled with the restructuring-friendly terms of EJ proceedings and the additional protections provided in the 2021 reforms, have provided companies, creditors, and practitioners with enough confidence to transform EJ proceedings into the "go-to" court-run restructuring process for a number of situations, including occasions where the debtor seeks the restructuring of a single class of debt obligations.

EJs should continue to grow as an attractive court-run process to address cross-border restructuring situations, raising the debtor's and creditors' confidence in the process.

Investment Funds in Brazil: The "New" Insolvency Regime and the Limitation of Liability of Investors

By André M. Mileski and Pedro Rocha*

In this article, the authors discuss a new resolution from the Brazilian Securities Commission that modernizes the regulatory framework for investment funds in Brazil.

On October 2, 2023, the Brazilian Securities Commission's (CVM) much-expected Resolution No. 175 (Resolution 175) came into force. The resolution modernizes the regulatory framework for investment funds in Brazil by regulating and setting force practices that have been adopted throughout sophisticated international markets, while consolidating local market practices and previous decisions rendered by the CVM's board.

The new framework is expected to be a "game changer" for investors in the world's fourth largest investment funds market,[1] with approximately BRL 7.4tn assets under management (comprising open-ended and closed-ended funds).[2]

This article explores the background to Resolution 175 and key procedures in the new framework, and examine the implications for investment funds.

BACKGROUND TO THE RESOLUTION

On September 20, 2019, the Brazilian Federal Government enacted Federal Law No. 13,879 (Economic Liberty Act) which modified Brazil's Civil Code to formally and statutorily govern investment funds in the country, while establishing a basic legal framework for the industry. With the enactment of the Economic Liberty Act, CVM was tasked with the mission to draft a new regulatory framework for investment funds that would set a legal course for investors and fund services providers regarding their liabilities before the investment fund and the CVM.

Since 2019, investors have therefore eagerly awaited two specific provisions previously disclosed and stipulated by the Brazilian government through the Economic Liberty Act. These were pending express regulations from the CVM

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* The authors, attorneys with Lefosse Advogados, may be contacted at andre.mileski@lefosse.com and pedro.rocha@lefosse.com, respectively.

[1] According to the CVM and IOSCO Investment Funds Statistics Report (2022-2023).

[2] Approximately $1.48tn (considering BRL1 / $0.20).

that would make Brazil "step up its game" and effectively join the international community when speaking about investment funds. The regulations specifically were regarding:

(i) Investors' limitation of liability to the value of their subscribed quotas (interests in the fund which confer participation in the fund);

(ii) The civil insolvency regimen for investment funds.

Brazilian-formed investment funds have distinct characteristics when compared to investment structures and/or investment funds in other jurisdictions. Local funds lack legal personality and are therefore not considered legal entities.[3] They may be formed as a closed or open-ended pool of funds, in the form of a "special nature" unincorporated pool of assets (*condomínio de natureza especial*).

This means that, pursuant to its sui generis legal nature/classification and prior to Resolution 175 and the Economic Liberty Act, investors of Brazilian-formed investment funds were subject to an unlimited liability regimen in case of any outstanding claims, liabilities, obligations and/or overdue charges and expenses of the investment fund that might have been incurred during its term of duration.

In other words, the "corporate limited liability veil," which normally protects and safeguards investors and quota holders of investment funds formed in foreign jurisdictions, would not be applicable to Brazilian investment funds, due to the fact that (i) local-formed investment funds are not considered legal entities and/or corporations with legal personality, and (ii) there was no legal provision (until the Economic Liberty Act) that expressly protected investors and quota holders from said unlimited liability.

KEY PROCEDURES OF THE NEW FRAMEWORK

On December 23, 2022, after a considerable two-year hiatus, which involved lengthy public hearings with the Brazilian capital markets players and experts, the CVM published Resolution 175. Although it will have a significant impact on Brazil's investment market, it is important to highlight that while the quota holders' limitation of liability is now permitted pursuant to Brazilian law, it is not mandatory. The investment fund's bylaws must expressly dictate such limitation and stipulate that the class of quotas in question is subject to the limited liability regimen by means of the inclusion of the suffix "limited

[3] In the Brazilian legal system, condominium does not have itself legal personality, but it may assume duties and obligations, as well as sue and be sued by third parties.

liability" in the fund's name. This is to distinguish the limited liability class of quotas from other classes of quotas that were not subjected to the limited liability regimen (within the same investment fund structure).

Additionally, Resolution 175 has set forth a procedure for whenever a class of quotas or investment fund's net equity is negative, and said class is subject to the limited liability regimen. In this instance, the fiduciary administrator must proceed with carrying out the following acts:

(i) First, to suspend and temporarily cancel: (a) the class' rights (if any) to redeem any quotas; (b) ongoing amortizations of quotas; (c) new and/or ongoing subscriptions of quotas; and (d) requests by quota holders to redeem quotas;

(ii) Second, to communicate: (a) to the investment fund's investment manager that the class of quotas net equity is negative; and (b) to the capital markets through filing of a material fact (*fato relevante*) for disclosure purposes; and

(iii) Third, within 20 days from said verification: (a) prepare (with the investment manager's support) a plan of action (i.e., contingency plan) to deal with the class of quotas' negative net equity; and (b) call the quota holders to convene at a meeting to render a decision with regard to the contingency plan prepared by the fiduciary administrator and the investment manager.[4]

At the quota holders' meeting, in case the investors decide not to approve the contingency plan proposed by the fiduciary administrator and the investment manager, the quota holders must decide on the following possibilities:

- Cover and pay up for the class' negative net equity, by the deployment of additional capital, with own or third-party funds, in amounts and terms aligned with the class;
- Spin-off, merger or amalgamation of the class of quotas to another investment fund, to which a formal proposal has been analyzed previously by the investment fund's service providers (i.e., fiduciary administrator and the investment manager);
- Liquidate the class of quotas with negative net equity, provided that there are no pending and outstanding obligations to be fulfilled with its remaining equity and assets; or

[4] The obligation set forth herein may be dismissed in case the investment fund's essential service providers decide that, after carrying out the actions described in items (i) and (ii) above, the negative net equity does not represent a risk to the classes' solvency.

- Make the fiduciary administrator file a judicial insolvency statement (i.e., bankruptcy statement) of the class of quotas with negative net equity.

In case the quota holders decide to file a judicial insolvency statement of the class of quotas with negative net equity, the fiduciary administrator will proceed with the disclosure and filing of a material fact to the Brazilian capital markets and proceed with necessary acts to cancel the class' functioning and maintenance registration before the CVM.

BANKRUPTCY AND RESTRUCTURING IMPLICATIONS

Despite the Economic Liberty Act and Resolution 175 setting forth "governance and legal entity aspects" to investment funds, investment funds in Brazil will not be subject to Federal Law No. 11,101 (dated February 9, 2005) regarding a special regimen for bankruptcy and extrajudicial/judicial restructuring (Bankruptcy and Restructuring Act).

Pursuant to the Bankruptcy and Restructuring Act, only corporate legal entities that act as business enterprises (*sociedades empresárias*) may be subject to the special legal regimen regarding bankruptcy and extrajudicial/judicial restructuring. Therefore, this excludes investment funds due to the fact that they do not fall within this legal category or classification.

Investment funds will be subject to a simpler civil insolvency (*insolvência civil*) proceeding following the provisions of the Brazilian Civil Code and Law 5,869/73, where the relevant competent jurisdiction or court will be commissioned with the task of mainly processing creditors' requests and proceeding with the liquidation of the class' assets, if there are any outstanding and pending debts against it. This is seen as a point of concern, especially considering that civil insolvency matters are expected to be judged by judicial circuits which are not specialized in business matters (as is generally the case in restructuring and/or bankruptcy matters involving corporations in Brazil).

These novelties will prove to be fundamental for both local and international investors when deciding to deploy capital in emerging markets like Brazil. Investors' equity, in theory, will be safeguarded from third-party claims should the resources and assets from the fund prove to be insufficient to pay off all debts and liabilities connected with it and its relevant service providers.

With the new regulations and the limitation of investors' liability coming into effect, relevant aspects will have to be observed by those doing business with Brazilian investment funds. For example, the credit risk analysis of local investment funds involved in business transactions, particularly involving structured and/or leveraged funds, is now duly recommended. This is something that was not required prior to the Economic Freedom Law and Resolution 175, considering that funds did not have investors' limitation of liability.

In addition, given its innovative nature, special attention should be paid to the role of the Brazilian courts in interpreting and applying this new legal feature. This will ensure that the limitation is in fact applied and there is no undue liability for the fund's service providers – the investment manager and the administrator – to the extent such service providers have discharged their fiduciary duties in rendering services to their administered and managed investment funds.

Negotiations and the Art of Communicating – Part II

By Peter J. Winders*

In this three-part series, the author discusses negotiating and communications, skills every bankruptcy lawyer needs. The first part of this column, published in the January 2024 issue of Pratt's Journal of Bankruptcy Law, *introduced the topic through engaging anecdotes, lessons and thoughts on listening and the gamesmanship of negotiations. This second part explains negotiating tactics in detail and mediation. The conclusion of this column, to be published in the next issue of* Pratt's Journal of Bankruptcy Law, *will cover humor in negotiations, and more.*

FUNDAMENTAL NEGOTIATION GAMES/TECHNIQUES

Learn to recognize the following negotiation games and techniques.

Tactics to Bolster Power or Threat

Real or Feigned Anger

Real anger in negotiating is quite dangerous, as it is in most other situations. Loss of control may cause a party to let slip information he did not intend to divulge, display weakness, or highlight the importance of a particular point that the opponent can exploit. But controlled or feigned anger can sometimes convince your opponent of your seriousness and may frighten him/her sufficiently to induce a change in position.

Counter measures to an angry or apparently angry opponent: carefully watch him for clues about what he really wants, weak points he is worried about, and the like. Or you may want to appear personally offended in a way that may provoke an apology, create guilt and precipitate concession to smooth things over. In some situations, a negotiator will choose to appear equally angry (or expound on the anger of his or her client). Often, it is the best move to terminate the conversation, with a guilt-producing "I will talk to you again when you calm down," adding, "We can't accomplish anything today," if it is important to keep the door open.

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* Peter J. Winders is a shareholder and general counsel at Carlton Fields, P.A., advising the firm and its members on legal ethics and professionalism, supervising the firm's educational programs on those subjects, and serving as the chief loss prevention and risk management officer. He may be reached at pwinders@carltonfields.com.

Aggression

Similar to anger as a negotiating ploy, the aggressive negotiator must carefully observe her opponent's verbal and non-verbal reactions to make sure not to trigger unintended reactions. Too much aggression can cause the opponent to walk away without resolution. In a transaction where the opponent has alternatives, he may not want a relationship with you. In the situation between lawyers representing clients in a dispute, there is extra expense dealing with a jerk, something you must put up with, document, and explain to your client.

Alleged or Pretended Expertise

The negotiator brags about his alleged expertise regarding small details to establish that a person is well prepared and in a superior position. This is similar to the stereotypical New York / District of Columbia lawyer discussed earlier.

Counter this by praising your opponent's knowledge and change the subject to more important items. Or if you think it an advantage, pretend to acknowledge his superiority and let your opponent continue to propose solutions to your objections, to your advantage.

Alleged or Pretended Superior Preparation

Very similar, this negotiator attempts to impress his or her opponent by overwhelming the opponent with detailed facts and figures during arguments.

This may be countered by asking the person to summarize his or her position without needless reference to superfluous data.

Take It or Leave It

A few negotiators will present their final offer at the outset, tell you that that is their evaluation and that they do not waste time in the usual back and forth auction game. It may be effective against a weak opponent, but do not count on it. There is a great risk that your opponent may not believe you. It is a first offer, after all. And most negotiators will want to believe that they have received a benefit from their own negotiating skills. It is a "small town" technique where the offeror has a well-known reputation of never backing down. In the labor union negotiating arena, it has a name – that of a former General Motors president – and has been declared an unfair labor practice, I guess because it must have worked.

Best or Final Offer

Similar to the above, if you make such a characterization, you must mean it and be prepared to walk away if the opponent rejects the offer. I recall both a Yosemite Sam cartoon and some famous political blunders, "I dare you to step over this line!" followed by, "Well, what about this line?" when the challenge is accepted. The offeror not only lost credibility, but also looks comical.

Consider retaining an out, such as, "Unless the client has a complete change of heart," "Unless the judge denies our motion to strike" or something similar. And reinforce with a restatement or reference to your principled position.

Tactics Using Powerlessness

Lack of Authority

This is a basic move, and often useful. You or your opponent claims not to be authorized to make or accept an offer, or an offer in the amount under discussion. It may be a truthful statement. It may be contrived, as when a lawyer tells his client, "Don't give me authority exceeding $10,000 for today's meeting." The advantage to a negotiator with limited authority is that it allows her to get what the opponent says is a best offer, while reading the clues (intentional or otherwise) as to how firm the "best offer" is. Because she has to get the reaction of her absent principal (the client, the boss, the sales manager) she may even choose to ingratiate herself personally by indicating she believes the offer to be "fair," while setting up one of the other negotiating gambits such as good cop/bad cop, described below.

Countermoves include disclaiming further authority yourself. "I understand, this is as far as I can go without my client's okay, too. He has been pretty stubborn about this. He thinks your client deliberately took advantage of him and wants to tell his story in court. But he has a practical side. I don't know what he will do." All of that can be made up within the conventions of negotiating. Or, suggest that the opponent call his principal to get more authority to take the offer that is on the table. Often, pressure to get the deal done today may help in getting a negotiator's best result.

Good Cop / Bad Cop

In this gambit there is more than one negotiator on one side, one of which is "reasonable" but the other is "adamant." The "reasonable" opponent sympathizes with your "generous" concessions but contends that you will need to do more to satisfy the unreasonable partner or client.

This technique sets a trap. You take the bait by trying to convince the "unreasonable" party, or worse, to satisfy him. Instead, try pretending to take the "reasonable" partner at his word, pretend you do not know what else to do beyond a reasonable resolution. This may put the "reasonable" player in a role where he might be forced to help you if he does not want to blow his cover. Even if that does not work, do not fall into the trap of in effect bidding against yourself.

One spontaneous example of this, shortly after I started practice, when still poor, we needed a new car. The car we had in Tennessee, where there is downhill for water to run, was unsuitable in the flat sections of Florida, where there are puddles. Every puddle cost at least one cylinder because the distributor (you may have to Google it) was designed to catch the splash from the right front wheel.

We were driving past a car dealership one evening and stopped in to look at the small Mercury one of my partners liked. These were the days when car buying involved a lot of negotiation, and it was customary to order the features you wanted rather than to buy off the lot. The stereotypical car salesman pointed to the largest Mercury, with all the options, told us he could make us a deal because the lady who ordered it had decided to buy a Lincoln, and asked if we would look at it. It was well above our means. He began to shave the price and cut it substantially, as he told me how it had some expensive option, and I told him I did not want that option and did not want to pay extra for something I did not want, or he could remove it. He was about at his limit and I at mine when my wife, who had been uncharacteristically quiet, said, "Peter, I don't like the color." "Well, that's it," I said. "Is there no price at which you think your wife will put up with the color?" (Still ignoring or underestimating the woman, as was the custom of car salesmen then even more than now).[1] "Well, maybe if I could get it at the price of the medium-sized car we came in to look at, but I don't know." The salesman left to talk to his manager (note the "I have reached the limit of my authority" ploy), and we could hear the discussion a few doors down as voices raised. "Take my word for it. He isn't going to buy it if she doesn't like the color. We will have to meet his price!" In the meantime, I asked Neta, "You really don't like it?" In an emphatic whisper, she said "Peter, I love that car!" She had fooled me as well as the salesman. As a negotiation tactic it was a brilliant good cop/bad cop move even though I was clueless about it.

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[1] Some of the professional women I asked to preview this have suggested I remove this parenthetical. On the other hand, all of my wife's caregivers have been taken advantage of by car salesmen. The stereotype of car salesmen still has a lot of validity.

Helplessness; Feigned Inability to Commit

Like the canine who rolls over to show helplessness before an alpha, some negotiators act helpless, as if they do not know what to do, thus asking you by implication or directly to help them. One lecturer I heard thought this was failure to play the game, so I concluded that he had been bested by such an approach, and was ignoring the proposition that one negotiator is not obligated to play the other negotiator's game. I have never deliberately tried it, but I have seen it work when someone was trying to sell me something I didn't want. The price got quite low, similar to the story about the chess set.

A variation is also an application of a "principled position" negotiation. Acknowledge that an offer is not unreasonable, but is not enough because of other factors. It works best when the opponent has a very high motivation to resolve the matter.

Responses can include: Do not allow yourself to be drawn into serial concessions to find your opponent's solution for him. Instead, try to force him to state his own position so that you have an established range. "I am not going to bid against myself. You are going to have to decide what you want to offer."

TACTICS TO CREATE GUILT

"You Were Unfair"

In this tactic, a party claims his opponent forced him into his present unreasonable posture by previous unfair actions. In one particularly clumsy attempt at this, a lawyer told the court that he had not filed his brief on time because I had consented to one extension and was a nice guy and would have agreed to another extension if he had asked, so he was misled. I responded that I probably would have. The court pointed out that it was the court order that there would be no further extensions that he ignored and I was off the hook.

Do not allow an opponent to create unfair guilt in you by raising prior matters that are not directly relevant to present negotiation.

"No Fair!" in Negotiating

In this variation, one party tries to create guilt in the opponent by complaining that he has made good faith offers and it is not fair that you have not given in or at least reciprocated. An accusation of unfairness can hit a sensitive nerve in a professional with a carefully maintained reputation. But see it for what it is. Just because he has made a concession does not mean he is entitled to one you do not want to make. This one reminds me of the scene in the movie "Just Friends" where the character Dusty Dinkleman says, "But I wrote a song for you! What kind of girl doesn't put out for somebody who wrote her a song?!" It deserves the same response.

"Gotcha"

Another effort to create guilt: one party pretends to seize upon her opponent's transgression, however small, to create needless guilt and anxiety and thus weaken the opponent's resolve. Examples: "You are 10 minutes late. I guess you don't have much any more interest in settling than you do in respecting our time," or overdue on a court obligation or another relatively unimportant mistake. The player makes a big deal about it.

Counter by apologizing appropriately (not as if it is as big an issue as opponent pretends) and either ignore the matter or promise to address it in due course.

Tactics to Create Presumptions or Control Agenda

Settlement Brochure

A written document, with pictures if appropriate, can help a negotiator establish a principled position, and create the impression in the opponent that there is little room to argue. The psychological hope is that the opponent will take the bait to argue what is wrong with the document, rather than present his or her own case.

The countermoves will vary.

First, consider whether the opponent's document will actually enhance your case. If not, do not make the mistake of quarreling with the brochure. To do so means that you have let the opponent set the agenda. Instead, argue the strengths of your position from your own agenda. In some instances, your own written presentation might be a good move.

This is similar to the technique described below where the partner shows up with the solution to the division of profits. But when that situation is in the context a fiduciary or quasi-fiduciary relationship, it borders on actual cheating, when in other situations it is simply an effective technique.

Arriving With the Surprise Solution

In the right situation, a written proposal creates a presumption that it is correct. Suppose a group is to divide profits or set salary points or divide assets.

Maybe a family business, a partnership, an estate. If Participant 1 comes to the meeting with a schedule already prepared, states that he has considered everyone's performance over the last year and done a lot of work (other participants have to insult him to criticize that) to create the schedule, the common reaction (the one hoped for by the preparer) is to see what adjustments to it should be made. If Participant 1 has given himself and three others a raise of 100% (he has to buy allies to avoid appearing only concerned with himself), chances are the discussion will start from there, and will either require objectors to "take" from one of those three or if they want to "give" to another party they will have to "take" it from someone. Participant 1 will end up with a 50% raise, but that is a lot better for him than the 20% he would have gotten without being the first to propose the agenda.

To counter this is difficult. One way would be to make copies of the list and have each participant come up with a similar list, average them and go from there, so as to eliminate the "presumption" effect that the original list has as a working hypothesis.

Oil on Troubled Waters

This technique is also most effective in multi-party negotiations, and has some of the effects of the Surprise Solution. A master of this tactic will sit back while others bicker, and at the appropriate time step in as peacemaker and offer a solution. Since the ire of the others has not been directed at the peacemaker, there is the impression that she is a neutral. One of my senior partners was a master at this and nobody but me seemed to remember that it was he who started the fight among the others in the first place.

Establish a Range

Somewhat similar to setting the agenda and creating the solution is the technique of proposing or establishing a range within which further negotiations will proceed. As a defendant, it is a great feeling when the range reaches the place where any settlement will be a success, given the cost, potential collateral damage to reputation and the like that a trial might bring. I assume the achievement of such a range for a plaintiff will feel similar.

Characterizing the Offer

"I have made you a fair offer." This is an attempt to make the opponent think that his declining or making a counteroffer is unfair. That should make you feel hesitant, particularly if your opponent seems to believe it.

There are several countermoves, each quite different depending on circumstances. First, ask to see evidence of fairness. In some situations, such as a labor negotiation, when part of the negotiations is what the company can afford, ask to see the books or confront with the company's annual 10-k report to the SEC. "An additional 1% of your profits is not fair after all." Second, agree that it is fair, or feign or admit ignorance. "I take you at your word that $25,000 is a fair price. But I do not like it more than $10,000. I will keep looking for something I like as well." Note that this is not arguable. If you argue whether the price is fair, it is antagonistic and is more likely to lead to a stalemate. If you do not argue that issue, but say what you are willing to pay, he will either meet your price or walk away. You must be willing to walk away, though. Third, leave negotiations open but do not let the opponent be the judge of what is fair. "Well the definition of a fair price is what a willing buyer and willing seller will agree to. I am willing to [pay or accept] $X."

Of course, characterizing the opponent's argument as unfair can have an effect as well. Will he be challenged to dig in, or will he feel a need to modify it? Most likely the former. A principled reason that it is insufficient will probably be more productive than a label.

Pretending to Lose

This can be very effective. Psychologically, it flatters your opponent, makes him feel successful, avoids bad feelings. "I believe you have outlawyered me. I have some defenses, but I have told my client you will probably overcome them. My client will pay a million dollars for a release. Well played!"

Do not fall for it. The only thing relevant in that statement is "a million dollars." If that is what your client wants, great. It is a lot of money. But if the case is worth $3M, do not let the praise cloud your judgment. "Thanks. I do think we have good facts on our side. I will run it by my client and get back to you as soon as I can."

Tactics In Auction Style Negotiations

Large Initial Demand

This move not only creates a high aspiration in the offeror, but it also may induce a naïve or careless opponent to raise his evaluation of the strength of your position, or modify his expectations. "Gosh, if he thinks the case is worth $2 million, maybe my evaluation at $200,000 is too low." It can be an important step in setting the ultimate range of the negotiations as well.

But it also risks causing the opponent to believe there will be no reasonable resolution, which may force you to retreat and damage your credibility.

Counter measures include characterizing a truly unreasonable initial offer as not genuine. "That is so out of the ballpark that I am going to ignore it." Or, "I will tell you my counteroffer is $10. Now let's start again. Tell me what your real first offer is."

False Demands and Giveaways

Hopefully, during the small talk around the start of the matter you will discover information about the opponents wants and concerns about the subject. Most good negotiators who discern that the opponent wants a particular concession, will pretend to value it highly whether they do or not, and give it up only for a large concession in return. It greatly strengthens your position if you have something of little value to you but much desired by the opponent. On the basic level, a retired trader in American Indian art told me in the late 1970s that when he started out he would fill the trunk of his car with items to trade and with $1000 in his pocket and return from the road trip with the trunk plus the interior of the car full and $10,000. "Trading is just people wanting what you have more than what they've already got."[2]

There is of course the risk that you misjudge the importance of your opponent's wants, and he will call your bluff. If so, counter by withdrawing your concession to try to regain your credibility. "Okay, I withdraw that offer," and make a different concession.

Tiny Incremental Concessions

Some negotiators will divide their concessions into small increments to give the impression that they are giving up more than the large concession they are actually willing to make. The aim is to give you the impression that you have drawn him into giving up more than he intended.

Do not be impressed with the number of concessions. Only the total amount is important. But be alert for the occasional negotiator that, like the unwary auction participant, loses his self control and seeks to get to yes as his goal, price notwithstanding.

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[2] That same trader stopped by my house, and seeing an old Navajo rug on the floor, said "I'll give you 3 times what you paid for that rug," without asking me what I had paid. Although we never engaged in negotiations, as I did not want to sell it, I thought that was an interesting gambit. A 200% profit is almost always welcome. I am sure that if I had overpaid and quoted an exorbitant price there would be an out for him, but the opening was designed to send the message that (a) he was not going to be cheap, trying to get the last nickel, and (b) he had a buyer that I had no access to.

"So What"

The negotiator tries to detract from an opponent's recent concession by representing it as either relatively unimportant or something which should have been granted at the beginning. "That was table stakes" or the like.

Again, he is characterizing your offer. One possibility is to withdraw that concession "since it is not significant" to him, and make a different concession. You will see if he is bluffing, and if he is, he is disadvantaged. His credibility is blown.

Boredom or Disinterest – Real or Feigned

In this one, a party appears totally disinterested or inattentive when opponent is making his/her best points in an effort to undercut both those points and her opponent's confidence.

The best counter may be to force such a party to answer your arguments. Ask her to identify any weakness in them. This is another application of the fundamental advantage of setting the agenda for the negotiations, this time as a countermove.

MEDIATION

Many or most U.S. courts now order the parties in civil cases to mediation. Mediation has its benefits and its drawbacks. Ninety percent of civil cases settle anyway. Mediation is a compressed, compelled, refereed settlement process. Without mediation the settlement dance can be a long process, with each party possibly reluctant to make the first suggestion of settlement for fear of communicating weakness. After that first step, the opponent may delay his response to feign disinterest. And so it can go. When the court orders mediation, those delays are off the table. The parties are forced to sit in a real or virtual room with each other and their lawyers, listen to each other for a while and then shuttle messages back and forth from separate rooms with the mediator as the messenger. There is typically a day devoted to this although it can be longer or shorter. If the matter settles, the mediator tells the judge it settled; if it does not and there is no sign it will, the mediator tells the judge the parties have reached an impasse. He does not tell the judge any details.

A day dedicated to settlement discussions is a good idea. The use of the mediator as a messenger complicates negotiations. The negotiator cannot read the expressions or weigh the words of the opponent. The mediator may interpret a position differently than you would in a face to face discussion. Not all of the negotiation tactics are off the table, but they have to be used differently. The mediator can only give the message that the opponent tells him to convey. But you can ask the mediator his impressions. "Do you think he wants to settle? What does he really want? To tell his story to the world, or to get his medical needs met? Get the encroaching building removed or get damages for the encroachment? Or sell his land for a good price? Is he after revenge?" Don't hesitate to ask the mediator. Then read the mediator.

Mediators talk in code too. "I can't really tell you if this is his final offer, but I think it might be good if you tried a significant counteroffer." From that statement, you can trust that the mediator believes the plaintiff will take less or the defendant will offer more than the current one. It is up to you whether to believe that your next move must be large or small. Whatever you choose to do, send it with a message, preferably a principled position, but if not, one that provides a reason for the counteroffer. A reason might provoke an opponent to try to meet the reason, rather than simply respond to a dollar offer.

Some mediators pride themselves in reaching settlement in most of their cases. I do not trust that sentiment, because it suggests to me that the mediator will be tempted to use her own negotiation skills against the weaker party to force a settlement. That would be giving in to a conflict of interest. But it is a tough job. Should the mediator lean on the weaker party because he has a weak case and his stubbornness is making him his own enemy? Or should he be neutral on that, as a neutral is supposed to be? Should he be completely indifferent to a recalcitrant party stubbornly walking off a cliff? Those are some interesting ethical issues that help complicate mediated negotiations but do not have anything to do with you as the negotiator in the mediation scenario.

In any event, from a negotiation standpoint, the mediator is an additional factor that the negotiator has to take into account.

Note that mediation is one situation in which the danger of believing one has to reach agreement because "We have wasted so much time" is always present. There is no wasted mediation. Settled or not, you learn much about the personality of the opponent, his view of the case, what she thinks are her strong and weak points. You can continue to negotiate without the mediator if it impasses. Or ask the mediator to carry another message if that seems advantageous.

EXTORTION

This column discusses extortion because it comes up more frequently than it should. In the practice of law context, we see it often enough to educate against it, educate on how to handle and counter it.

The common law crime of extortion is obtaining money (or something else) by threat. "If you don't pay me $X, I will [vandalize your business][break your legs][report to the police what I saw you do][publish the pictures]," etc. Note that it is the threat that is the crime. One may have a perfect right to report to the police what he saw. The crime is threatening to do so unless money (or something else) is paid. The fact that the money is actually owed does not make a difference. The crime is the threat as a way to collect it. Debts should be collected through the courts when necessary, not through self-help (so a threat to file suit is not a prohibited threat). But sometimes a person with a legitimate claim (or his lawyer) will try to capitalize on the possible extra embarrassment of the claim by threatening to call a press conference if an excessive demand is not met.

First, never do that.

Second, the best way to handle that, if the threat is transmitted by a lawyer (or if the claimant has a lawyer) is to send a written response, clearly identifying the letter as extortionate, taking the position that the recipient of the threat refuses to deal based on threats, but is willing to discuss any real claim on its merits. If the lawyer has a boss, copy him or her. At least somebody in the firm will recognize that the client or lawyer risks bar discipline, or damage to reputation, or both, by such improper threats. Obviously, do not actually say that in the writing – that borders on extortion! The cooler heads will also recognize that if the threat is carried out, there is no incentive to resolve the issue at a beneficial level.

Also, please realize that there is no need for an extortionate claim. The opponent's own imagination will work in your favor far better than a threat. If all you do is tell him you are going to sue, he and his lawyer will fill out the consequences, real or imaginary. I once represented an employer who sued one of its traveling salesmen when it discovered he was carrying his own cheaper competing line of products in the company vehicle so he could undercut his employer for his own account if necessary. Being a good salesman, he both lied about it and explained his noble purpose of looking after his customers. His income tax returns showed he reported no income from the sales he made on the side. But I obtained his state sales tax returns which he faithfully filed. He gave up because he convinced himself I or my client would report him to the Internal Revenue Service. I had no intention of doing so, but his own imagination persuaded him.

The potential defendant threatened with a press conference will realize that the publicity of the potential lawsuit will be a disaster. The extortionate letter spelling that out actually gives the defendant a negotiating advantage if the defendant calls him on the use of threats as previously outlined.

FUNDAMENTAL RULES OF DEFENSE AGAINST NEGOTIATING GAMES

The following observations apply to all negotiations no matter what tactics your opponent uses. They are psychological traps inherent in any negotiation.

Avoid a "Need to Settle Today" Mindset

Like the auction bidder who gets so caught up in the process that he needs to win, some negotiators can fall into the "Dollar Auction" trap of giving more and more because of a need to resolve the matter.

Similarly, many extended negotiating sessions, as is often the case with court-ordered mediation, settle because 'we have wasted all this time' otherwise. Recognize that this psychological temptation exists, guard against it, use it on the opponent, and do not resolve the matter unless the result is truly satisfactory.

Always Have an Alternative

Except in truly unusual situations, there should always be an exit strategy. There is always an alternative to a negotiated solution: you should always be willing to walk away, to try the case, etc. Being prepared for that result strengthens any position. Failure to have such an alternative weakens a negotiator. In litigation, because 90% of filed cases settle, some lawyers count on that and are not fully prepared to go to trial. This puts them at a settlement disadvantage to an opponent who is ready to do so.

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Editor's note: The conclusion of this column, which will appear in the next issue of *Pratt's Journal of Bankruptcy Law*, will explain humor in negotiations, and more.