Table of Contents

<table>
<thead>
<tr>
<th>Country</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td>1</td>
</tr>
<tr>
<td>Argentina</td>
<td>3</td>
</tr>
<tr>
<td>Australia</td>
<td>22</td>
</tr>
<tr>
<td>Austria</td>
<td>38</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>47</td>
</tr>
<tr>
<td>Belgium</td>
<td>53</td>
</tr>
<tr>
<td>Brazil</td>
<td>70</td>
</tr>
<tr>
<td>Canada</td>
<td>85</td>
</tr>
<tr>
<td>Chile</td>
<td>103</td>
</tr>
<tr>
<td>China</td>
<td>113</td>
</tr>
<tr>
<td>Colombia</td>
<td>121</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>132</td>
</tr>
<tr>
<td>Egypt</td>
<td>139</td>
</tr>
<tr>
<td>England and Wales</td>
<td>147</td>
</tr>
<tr>
<td>European Union</td>
<td>163</td>
</tr>
<tr>
<td>France</td>
<td>174</td>
</tr>
<tr>
<td>Germany</td>
<td>184</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>204</td>
</tr>
<tr>
<td>Hungary</td>
<td>214</td>
</tr>
<tr>
<td>Indonesia</td>
<td>224</td>
</tr>
<tr>
<td>Italy</td>
<td>232</td>
</tr>
<tr>
<td>Japan</td>
<td>265</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>276</td>
</tr>
<tr>
<td>Malaysia</td>
<td>284</td>
</tr>
<tr>
<td>Mexico</td>
<td>290</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>303</td>
</tr>
<tr>
<td>Philippines</td>
<td>317</td>
</tr>
<tr>
<td>Poland</td>
<td>328</td>
</tr>
<tr>
<td>Russia</td>
<td>340</td>
</tr>
<tr>
<td>Singapore</td>
<td>361</td>
</tr>
<tr>
<td>South Africa</td>
<td>369</td>
</tr>
<tr>
<td>Spain</td>
<td>383</td>
</tr>
<tr>
<td>Sweden</td>
<td>406</td>
</tr>
<tr>
<td>Switzerland</td>
<td>413</td>
</tr>
<tr>
<td>Taiwan</td>
<td>420</td>
</tr>
<tr>
<td>Thailand</td>
<td>429</td>
</tr>
<tr>
<td>Ukraine</td>
<td>434</td>
</tr>
</tbody>
</table>
Foreword

We are pleased to present the revised edition of Baker McKenzie’s Global Insolvency & Restructuring Guide.

This edition of the Guide has been expanded to encompass developments in the law of insolvency and restructuring through September 2016. Many of these respond to the recent financial crisis and reflect a growing trend of allowing for increased flexibility in formulating compositions and restructuring plans.

Baker McKenzie has provided sophisticated legal advice and services to many of the world’s most dynamic and global organizations for more than 50 years.

We are a law firm of more than 4,000 locally qualified, internationally experienced lawyers in 75 offices in 47 countries. We have the knowledge and resources to deliver the broad scope of quality legal services required for a consistently effective response to international and local needs, with confidence and a sensitive awareness of cultural, social and legal practice differences.

The Guide has been compiled by Baker McKenzie lawyers experienced in the practical aspects of restructuring and insolvency. It should provide you with a helpful tool to understand the numerous insolvency and restructuring regimes that may affect your business.

Our lawyers have been advising on some of the largest and most complex multijurisdictional restructurings, recoveries and insolvencies for many years. Unlike many firms, we have the fluency to manage local regulatory, tax, employment, disputes and other legal issues that arise. Our ability to mobilise experienced multidisciplinary teams across borders produces efficiencies that often make a critical difference in the outcome of any restructuring or insolvency.

As ever, a broad review such as this cannot deal with some of the more detailed issues or circumstances that might arise in particular settings. Please do not hesitate to follow up with us or any of our colleagues if we can be of further assistance. Contact details for each country can be found at the end of the relevant chapter of the Guide.

Debra A. Dandeneau and Ian Jack
Co-chairs, Global Restructuring & Insolvency Group
Baker McKenzie
Argentina

Overview and Introduction

This Guide analyses the reorganisation and bankruptcy (liquidation) proceedings under Bankruptcy Law No. 24,522 as amended (“the BL”). The BL was enacted on 8 August 1995 and became effective on 11 November 1995. The BL was amended afterwards on several occasions, most recently by Law No. 26,684 in 2011.

Reorganisation Proceedings

General Considerations Regarding Reorganisation Proceedings

Filing for Reorganisation Proceedings

Under the BL, the prerequisite for filing for reorganisation proceedings (“reorganisation”) is the status of cessation of payments of debts on a general and regular basis (estado de cesación de pagos), whatever the cause or nature of the debt may be.

Reorganisation includes all assets of the insolvent company or natural person and the whole of the debtor’s estate, with a few exceptions in connection with debts that are secured by liens.

Corporations must file for reorganisation through their legal representatives. This resolution from the board of directors should be ratified by a shareholders’ meeting within 30 days of filing.

The requirements when filing for reorganisation are as follows:

- evidence of registration of the company with the Public Registry of Commerce and filing of its articles of incorporation and by-laws and amendments thereto;
- a comprehensive explanation of the current net worth/equity status of the company, date of suspension of payments and the facts that led to such suspension;
- an updated statement detailing and assessing the assets and liabilities, with a precise indication of their composition, the rules used to ascertain their current valuation, the location, condition and liens on such assets, and other necessary information to enable an accurate assessment. This statement should be annexed to a report made by a certified public accountant;
- a statement indicating the debtor’s employees with relevant information for purposes of identifying them, and an accounting certification of any potential debt to social security institutions;
- copies of the debtor’s financial statements, including balance sheets and other accounting statements requested by law, corresponding to the last three fiscal years, along with the reports from both the board of directors and the supervisory committee;
- a list of the existing creditors specifying: their domiciles, the value of their claims, their cause, maturity dates, co-debtors, guarantors or third parties liable or responsible, and the priority of the claims. An additional file for each creditor, along with a copy of the documents supporting the claim, and a report from a certified public accountant on the financial statements of the company and its accounting entries, books and documentation, must be annexed to the filing, along with details of
all existing judicial or administrative proceedings, indicating the court with jurisdiction
over them. The report from the certified public accountant must expressly indicate
whether there are any other labour claims that are unpaid;

• a list of all commercial and corporate books held by the company, which should also
be filed with the court; and

• a declaration of the existence of any previous reorganisations.

Based on a preliminary analysis of the documentation filed, the court should decide, within
five days of the filing, whether to reject or sustain the petition. The court’s resolution
sustaining the petition and initiating the reorganisation must set forth the following:

• the date of the hearing to appoint a reorganisation trustee (the *síndico*);

• a deadline for creditors to file their proofs of claim at the trustee’s office (see point (b)
under “The Reorganisation Plan” below);

• an order to publish legal notices in the corresponding newspapers;

• a deadline for the debtor to file with the court all commercial books of the company;

• an order to register the opening of the proceedings with the corresponding public
registry;

• a temporary restraining order against buying, selling or creating encumbrances on
the assets of the company;

• an order to pay mailing expenses in regard to the communications to be sent to the
creditors reported by the company;

• the dates on which the reorganisation trustee must submit his report on the proofs of
claim (see point (c) under “The Reorganisation Plan” below) and a general report
describing the company’s financial condition (see point (e) under “The
Reorganisation Plan” below);

• the appointment of an informative hearing, which shall be notified with special
formalities to the debtor’s employees; and

• the appointment of a temporary creditors’ committee, which shall include one
representative of the debtor’s employees.

**Effects of Filing for Reorganisation**

The initiation of the reorganisation proceedings results in the following:

a) the existing management of the company keeps the administration of the company’s
assets under the supervision of the reorganisation trustee and the temporary
creditors’ committee. However, the administration is restricted and certain acts are
forbidden, i.e.:

(i) the company may not dispose of its assets for no valuable consideration or
through any act affecting or modifying the creditors’ condition;

(ii) previous court authorization is required to perform acts related to assets
subject to registration, the sale or lease of the going concern, issuance of
bonds or secured negotiable debt, grant of liens, or acts beyond the ordinary course of business.

The necessary authorization should be requested from the court, which must first discuss the request with the reorganisation trustee and the creditors’ committee. All acts performed in violation of the above-mentioned rules have no legal effect against creditors admitted to the reorganisation;

b) if any violation of the above-stated rules occurs, the administration of the company passes, through a court order, to a reorganisation trustee. Nevertheless, in some circumstances the court may instead decide to limit the administration of the company by appointing a co-administrator or a controller, rather than allocating the administration to a reorganisation trustee;

c) the suspension of the accrual of interest on any existing unsecured credit as of the date of the filing;

d) the company may continue performing its obligations under any existing contract in which mutual obligations are still pending (e.g. a license agreement) by securing previous authorization from the court. The counterparty may request the company to fulfil those obligations that were due and outstanding on the date the reorganisation was filed. Should the counterparty not be given notice of the decision to continue with the contract within 30 days of the commencement of the reorganisation, the counterparty is then entitled to terminate the contract;¹

e) the supply of public utilities to the company may not be suspended after the date of the filing;

f) in principle, all monetary lawsuits existing against the company at the time reorganisation is sought will be suspended and must be forwarded to the court intervening in the reorganisation. However, lawsuits concerned with labour or those of extensive evidence production (juicios de conocimiento) may be continued before the courts where they were initially filed, at the creditor’s option. If the creditor exercises the option, it will have the right to request admittance of the claim in the reorganisation within six months after the date on which the ruling on the merits becomes final in the litigation. The above obligation to suspend litigation proceedings and remit the litigation to the reorganisation court does not apply to divorce and associated ancillary relief proceedings, actions for expropriation by the government or execution of collaterals;

g) no new lawsuits for collection of debts incurred before the filing for reorganisation may be filed against the company;

h) all preliminary injunctions levied against the debtor may remain in force but that does not affect the status of a claim as secured or unsecured. However, all foreclosures are suspended. No precautionary measures are allowed in lawsuits excluded from the jurisdiction of the reorganisation;

i) in case of evident urgency or need to the company, the court may suspend auctions in mortgage or pledge foreclosure proceedings. This suspension may not exceed 90 days;

¹ Any private agreement executed by the company and third parties in violation of the rules described above at (d), (e), (f), (g) or (h) is null and void.
j) statutory managers and officers of the company may not travel abroad without previous notice to the court and for no longer than 40 days. Longer periods of travel require special court authorization;

k) the BL had a strong system for labour claims protection, which was furthered with the entry into force of Law No. 26.684, which strengthened such protection in the so-called early payment (pronto pago). There are two alternatives. The first is automatic payment, in which the trustee prepares an audit of employee benefits according to the debtor’s accounts to be submitted to the court. If certain conditions are met, the judge orders payment of wage claims in the report. The second is employee-driven, in which the request is forwarded to the trustee and the debtor. In both cases, the claims are paid with the available liquid funds of the debtor company and, in their absence, with no less than 3% of gross income.

The Reorganisation Plan

After the filing and the court’s ruling initiating the reorganisation, the proceedings continue as follows:

a) the court resolution initiating the reorganisation is published for five consecutive days in the official gazette and in another major newspaper local to the place of business of the company;

b) unsecured creditors must file with the reorganisation trustee a proof of claim supporting the existence and legitimacy of their claims, together with the following:

   (i) a power of attorney, authorizing one or several local attorneys to represent the creditor before the Argentine courts;

   (ii) originals or copies of the invoices and receipts related to the services or products delivered or sold to the company;

   (iii) original documents related to export transactions;

   (iv) original bills of lading (in the case of export operations);

   (v) relevant original letters and correspondence exchanged between the parties or any other documents in connection with the transactions (mortgages, pledges or any other security interests);

   (vi) an affidavit from a foreign attorney stating that the law of the foreign jurisdiction does not discriminate against Argentine creditors whose claims are payable in the foreign country;

   (vii) a legal fee - equal to 10% of the minimum official labour wage which is periodically adjusted - to be paid by each creditor to the reorganisation trustee for costs and expenses. This amount is added to the claim. The amount of this legal fee is at present approximately AR$ 800.

If a special trustee represents bondholders (“bondholders’ trustee”), the BL allows the bondholders’ trustee to submit the proof of claim on behalf of its note/bondholders in order to be admitted by the court as a creditor.

Those creditors that do not file their proofs of claim on time may file a late petition within two years of the date of filing the petition for reorganisation. In such cases, the creditor will most likely be ordered to pay the fees of the reorganisation trustee’s
attorney, which range from 0.22% to 5.4% of the registered credit (or proved claim),
taking into consideration, inter alia: the amount of the claim; the nature and
complexity of the claim; and the merits and results of the attorney’s performance;
c) once the proofs of claim have been filed, they may be objected to by the company
and/or any creditor within 10 days from the deadline to file the proofs of claim;
d) on or before the date fixed by the court in its opening order, the reorganisation
trustee should file the report advising the court to accept or reject each of those
claims. In order to prepare the report, the reorganisation trustee is authorized to
analyse the company’s accounting books (and, in certain cases, the creditors’ books)
and furnish himself with all the elements that he may consider useful to determine the
validity of the claims. The trustee may require information from creditors if required;
e) final acceptance of the claims is subject to the court’s decision. The creditors or the
company may challenge the decision within 20 days from its issuance through a
special reconsideration proceeding (the incidente de revisión);
f) creditors secured by a lien, pledge or any other security interest must also file a
petition for the admission of their claims in the same manner as the unsecured
creditors. However, secured creditors may request, at any time, payment of their
claims through the sale of collateral. The court and the reorganisation trustee must
examine the document(s) supporting the request and order the sale of the collateral
by public auction. The court may request the posting of a security bond. After the
public auction sale, creditors are paid principal and accrued interest. Creditors with
security interests should seek admission of their claims. Once admitted the secured
creditor may continue the process of enforcement of the security. Note that once the
claims are admitted in the reorganisation proceedings, they are called créditos
verificados in Spanish;
g) the reorganisation trustee should also file the general report, which contains:
   (i) an analysis of the causes of the insolvency;
   (ii) details of assets and liabilities, along with an estimation of their value in case
        of sale;
   (iii) a list of the company’s accounting books, with a report on their status;
   (iv) details of the company’s registrations with public registries, containing full
        names and domiciles of the members of the board;
   (v) the date from which payments were no longer honoured (i.e. the date of
        suspension of payments);
   (vi) a statement as to whether the shareholders have routinely complied with their
        capital contributions and whether they have incurred in any kind of liability
        vis-à-vis the company and/or the creditors;
   (vii) a list of acts that should be revoked. Certain acts that occurred two years prior
        to the filing for reorganisation may have no effect for creditors admitted to the
        reorganisation;
   (viii) an appraisal of the assets of the company;
   (ix) a determination of whether anti-trust law applies;
h) once the court rules on the admission of the claims, the company should file a proposal to rank the admitted creditors, based upon the value of their claims, the existence of security interests, the nature and cause of the claims, or any other relevant factors. The proposal must set out three categories: unsecured commercial creditors; unsecured labour creditors; and secured creditors;

i) the court then rules on the ranking of the creditors, approving or modifying the proposal filed by the company. The court’s decision should also appoint the new members of the temporary creditors’ committee, which must include the main creditor within each category;

j) the company has a term during which it manages the presentation of a proposal of payment to its creditors as well as the filing of such proposal with the court. First, the company files a report to the court stating the terms of the proposal to be made to each category of creditors. The payment proposal may differ from one category to another. The report must be submitted to the court within 20 working days before the expiration of the “exclusivity period”, i.e. the term determined by the court to allow the company to negotiate the terms of payment with the different categories of creditors. The length of the exclusivity period is set together with the court’s decision described in (i) above, and cannot be less than 90 working days or more than 120 working days from the ruling. The company should file the acceptance of the creditors to the reorganisation plan before the expiration of the exclusivity period. Otherwise, the court should declare the company’s bankruptcy. The reorganisation plan may consist of a reduction in the amount of the debt, an extension thereof or both combined, as well as the issuance of negotiable debt notes or other similar instruments, or the granting of collateral. The reorganisation plan should also include: an administration regime and restrictions on any disposition of assets, both applicable during the fulfilment period of the reorganisation plan; and the selection of the final creditors’ committee, which will control the performance of the reorganisation plan (and which will replace the temporary creditors’ committee: see (i) above). A minimum of three members is required, selected from among the major creditors of each category. The final creditors’ committee is fully authorized to advise and report, to request information and documentation of any nature from the company and reorganisation trustee, and to submit petitions to protect the creditors’ rights. The final creditors’ committee must file with the court a quarterly report of its activities;

k) as noted above, before the end of the exclusivity period, the company should file the written approvals of the unsecured creditors whose claims were admitted by the court to the reorganisation plan. The plan should be approved by the majority of the unsecured creditors (i.e. more than 50% of the unsecured creditors accepted by the court included in each rank), whose claims represent at least two-thirds of the admitted claims corresponding to each category of creditor. Should the company obtain the legal majorities in each rank, the court will declare the existence of a reorganisation plan.

The bondholders’ voting regime under the latest amendment to the BL is as follows:

(i) the bondholders’ trustee or the court calls a bondholders’ meeting;
(ii) the bondholders declare in the bondholders’ meeting whether or not they accept the proposed reorganisation plan;
(iii) the plan is approved if it is accepted by a majority of bondholders voting, which hold a majority of the amount of claims;
(iv) the BL states that the bondholders’ meeting may be avoided if the indenture provides an alternative way of obtaining approvals to the reorganisation plan and the court accepts it;

(v) in cases in which the bondholders’ trustee was admitted as the creditor on behalf of the bondholders, it is allowed to split its vote;

(vi) in every case, the court may provide measures to ensure that every single creditor participates in the voting and that the voting procedures are being properly implemented;

l) the BL provides that if at the end of the exclusivity period the debtor obtains the required majorities without objections, or where objections are made, they are disregarded by the court, then the court should approve the reorganisation plan. When a proposal does not obtain the required majorities from all classes of creditors, the court may nevertheless approve the proposal if: the proposal is approved by at least one class of unsecured creditors and by the holders of a minimum of three-quarters of the aggregate value of unsecured claims; the court considers that the proposal is fair and that it does not unreasonably discriminate against any dissenting class of creditors; and payments to be made pursuant to the reorganisation plan are not lower than the ones that would have been received by the creditors who rejected the proposal had the debtor been in bankruptcy;

m) in between the court’s ruling that declares the existence of the reorganisation plan (see item (k) above) and the court’s ruling that approves the reorganisation plan (see item (l) above), any creditor has the right to object to the plan, based on: mistakes in the consideration of the legal majorities; insufficient representation of the creditors; fraudulent increase of the company’s liabilities; fraudulent increase or decrease of the company’s assets; and failure to comply with formal requirements. If the objections filed by a creditor succeed, the court should immediately dismiss the reorganisation plan and declare bankruptcy;

n) the approved reorganisation plan is mandatory for every unsecured creditor whose claim originated before the filing for reorganisation, whether it has participated in the reorganisation proceedings or not;

o) in all cases, the reorganisation plan approved by the court constitutes the novation of all the obligations with origin or cause prior to the reorganisation proceedings. This novation does not negate the obligations of any guarantors; and

p) if the company does not secure the approval of the legal majorities outlined in item (k) above, the court must declare its bankruptcy unless cramdown proceedings (see below) become applicable.

**Conclusion of the Reorganisation**

The court should close the reorganisation proceedings once: the reorganisation plan is approved by the court; all measures aimed at the fulfilment of the obligations in the reorganisation plan are taken; the pertinent guarantees are granted; and the general injunction forbidding the disposal of assets that applied during the reorganisation process is reinforced by the court (unless the creditors expressly agree to remove such preliminary injunction). Once the proceedings are closed, the duties of the reorganisation trustee and the duties of any individual appointed by the court to supervise the management of the company end.
Out-of-Court Reorganisation Agreements

The debtor and its creditors may reach agreement and execute an out-of-court agreement (acuerdo preventivo extrajudicial) and file it in court to obtain the creditors’ approval. This is similar to pre-packaged bankruptcies under the US Bankruptcy Code.

The parties may include in the out-of-court agreement whatever content they consider appropriate to their best interests. The agreement is binding on the parties thereto even if rejected by the court, unless they expressly agreed otherwise.

The out-of-court agreement is to be filed with the competent court along with a set of documents, including an updated statement of assets and liabilities, a list of creditors and the value of their claims, co-debtors, guarantors or third parties liable as regards these claims, a list of pending actions and administrative litigation, the amount of capital represented by the creditors who have signed the agreements, and the percentage this represents with respect to the total registered creditors of the debtor.

To request court approval and make the out-of-court agreement enforceable against all the creditors, the agreement must be executed by a majority of creditors representing two-thirds of the debtor’s unsecured debts.

The creditors, whether they fall within the scope of the agreement or not, may object to its approval by the court, but only on account of omissions or artificial increases of the debtor’s assets or liabilities, or a failure to secure the majorities required by the BL.

If there are no objections to the out-of-court agreement, or when the objections have been dismissed by the court, and the required formalities are met, the court may approve the out-of-court agreement. Once it has been approved, the out-of-court agreement and the actions taken, or documents executed, in compliance with it may be validly enforced on any unsecured creditor — even a creditor who has not signed the agreement and has not participated in its formulation — and on those secured creditors who were party to the agreement.

Cramdown Proceedings

The BL allows creditors and any other interested parties to propose and obtain acceptance of a buy-out plan if the debtor’s payment proposal is short of the required majorities. Therefore, if the debtor is a commercial company, the lack of approval of a reorganisation plan would not be automatically followed by the debtor’s bankruptcy. The proceedings set forth by the BL for this optional buy-out plan are governed by the following general terms and conditions:

a) a register of creditors and third parties interested in the acquisition of the company through the purchase of its stock (the “interested parties”) is opened for five days. If there are interested parties, the court must estimate the market value of the stock of the company based upon an appraisal conducted by an investment bank, a financial entity, or an audit company, or an appraisal carried out by experts appointed by the court at the proposal of the creditors’ committee. If no creditor or third party is interested, the debtor is declared bankrupt;

b) the interested parties should negotiate with the creditors and obtain their approval of the plan filed by the interested parties to cancel the debtor’s liabilities admitted by the court. The first interested party to secure the required creditors’ approval must inform the court and, should the plan be approved by the court, the interested party is entitled to acquire the company’s stock at a price to be determined as follows:
(i) when, as a result of the valuation of the company, the court determines the non-existence of a “positive value” of the stock, the interested party is entitled to request the immediate transfer of title to the stock along with the approval of the plan so agreed with the creditors and without any further proceeding, payment or requirement;

(ii) in the event of a “positive” valuation of the stock, its amount should be reduced in the same proportion as the debtor’s unsecured liabilities are reduced at their present value as a consequence of the agreement reached with the interested party, at the court’s discretion. To establish the present value of the debtor’s unsecured liabilities, the court takes into consideration the contractual interest rate upon the claims, the interest rate in force in the Argentine market and the international market, if applicable, and the relative risk position of the debtor company;

(iii) once the value has been judicially ascertained, the interested party may:

• obligate himself to pay the amount due to the partners or shareholders of the company, by depositing 25% of the price as a security, within 10 days following the judicial approval of the reorganisation plan; and transfer of title to the stock will take place immediately thereafter; or

• within the following 20 days, agree on the acquisition of the stock of the company for a value lower than the one determined by the court, by obtaining the consent of the shareholders representing two-thirds of the corporate capital of the company. Once such consents have been obtained, the interested party must serve notice thereof upon the court and pay the resulting balance, according to the formalities and on the dates specified in item (a) above. After complying with these requirements, the interested party acquires title to the stock of the company;

• if none of the interested parties and/or the debtor obtains the required creditors’ approvals, then the court will declare bankruptcy.

The BL allows the interested parties to bid for the company while, at the same time, the debtor is given another opportunity to negotiate with its creditors, although with no preference over the interested parties. The company must be appraised at fair market value and by an independent appraiser. In the past, it was appraised at book value. The BL includes other provisions that have made the whole process generally more flexible.

Reorganisation of an Economic Group

Companies that are part of an economic group may file for reorganisation as a group, provided that they have previously proven the existence of said economic group. The filing for reorganisation must include all the companies of the group, without exception. The court may reject the filing when the existence of the economic group is not duly evidenced. Such a decision may be appealed.

Although the rules are generally the same as those applied to a single company’s reorganisation, specific rules apply in such cases:

• the court may appoint more than one reorganisation trustee;

• there should be one proceeding for each company;
• the reorganisation trustee should file a general report specifying the general net worth/equity of the economic group;

• the companies of the economic group may file unified proposals of categorization and proposals of payment considering the liabilities of the economic group as a whole;

• the legal majorities to approve such proposals are the same as those described in point (k) under “The Reorganisation Plan” above. However, the proposals will also be considered duly approved if the economic group obtains approvals from more than 75% of the whole amount of claims accepted in all proceedings of the economic group and more than 50% of the amount of claims in each category;

• should the legal majorities not be obtained, the court will declare the bankruptcy of all the companies within the economic group.

Bankruptcy

General

Bankruptcy in basic terms means termination or judicial liquidation of the legal entity. Bankruptcy is only reached through the intervention of the Commercial Court corresponding to the jurisdiction where the company is registered. For bankruptcy declaration purposes, one sole unpaid creditor is sufficient.

The BL does not deprive shareholders of a bankrupt company from ownership of their stock. Shareholders are unrestricted in keeping or selling stock at their discretion. Upon bankruptcy declaration, the legal entity ceases to exist as it did before. The bankrupt entity is thereafter managed by the bankruptcy trustee (síndico) under the supervision of the competent court.

In general terms, the basis for becoming bankrupt is that liabilities outnumber assets and that the debtor has a “cessation of payments” status (estado de cesación de pagos) (described below). A company that meets these tests may be declared bankrupt under the following circumstances:

• at the debtor’s own request for bankruptcy;

• at the request of any creditor upon total or partial default of any liquid and unpaid obligation, or any breach of a reorganisation plan;

• at the request of the creditors’ committee upon total or partial default under the reorganisation plan;

• upon declaration of nullity of the reorganisation plan requested by any creditor.

Cessation of payments is not a mere default on payments or breach of a single obligation. It is a general status of a permanent nature that constrains the debtor from fulfilling payments with ordinary resources on a regular basis. The BL provides a more detailed list of cessation of payments indicators, upon which a debtor may be judicially considered insolvent and for purposes of determining the “insolvency date” (a defined term):

• the debtor’s acknowledgment that it is unable to honour its debts or a previous reorganisation plan;

• default on payment of debts (within the terms explained above);

• the debtor’s managers are missing or hiding and no representative is available;
the administrative headquarters are shut down;

the assets are being sold at an outrageously low price, are hidden or are transferred in payment of previous obligations;

upon judicial reversal of any fraudulent and creditor-impairing activities;

whenever the debtor is performing any ruinous activities for purposes of obtaining economic resources.

According to section 116 of the BL, the reversal period (*período de sospecha*) starts on the insolvency date and ends on the bankruptcy award date. The reversal period may not go back further than two years from the bankruptcy award date. Sections 118 and 119 provide that certain acts performed during the reversal period may be reversed by the court, such as:

- those activities performed for no consideration;
- payment of debts before they become due;
- securing obligations that were originally unsecured;
- any activities with respect to which the counterparty knew of the company’s cessation of payments status at such time and out of which the creditors suffered losses.

Effects
The main effects of bankruptcy are as follows:

- the debtor loses possession of its assets, which must be given to the bankruptcy trustee (some exceptions apply);
- the debtor may not receive payments of any kind;
- the bankruptcy trustee assumes the administration of the debtor company’s assets and the complete control of the business. However, the trustee might recommend the court to continue the debtor’s business if it would be deemed beneficial for the debtor, or if two-thirds of the debtor’s employees so request. The National Government should provide technical guidance to the debtor’s employees (if requested), should they continue to run the business with the court’s authorization;
- the debtor company’s directors are disqualified from performing commercial activities within the territory of the Argentine Republic for one year from the date of suspension of payments.2 The beginning and ending dates of this one-year period will be determined at the ruling declaring the debtor’s bankruptcy. (This restriction may be reduced or removed by the court if the representatives have not committed fraud or any other act in violation of the criminal law);
- the court orders the immediate liquidation and auction of the company’s assets;
- the creditors should file a proof of claim for the purpose of being registered with court;
- all pending claims become due as of the bankruptcy award date;

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2 This is expanded upon below.
• interest accrual is stopped as of the bankruptcy award date, except for some secured claims;

• the debtor or its directors must request authorization from the court to leave the country until the filing of the general report. Directors who reside outside Argentina are not prohibited from entering the country. The restriction applies only for the purpose of leaving the country;

• any exchange of mails or other communications with the debtor company will be delivered to the trustee;

• where there are reciprocal pending contractual undertakings between the debtor and any third party, the court will determine whether or not the agreement should be terminated;

• all non-integrated capital contributions from the company's shareholders should be paid in.

Liquidation of the Debtor’s Assets

Under the BL, the bankruptcy trustee must carry out the auction of the company’s assets within four months from the date of the bankruptcy award. In exceptional cases, the court may authorize an extra 30 days. However, in practice, the liquidation of assets takes much longer, depending on the complexity of each proceeding, the amount involved, and the characteristics and location of the assets.

The debtor company's assets may be auctioned in three different ways:

• auction of the company’s complete assets (“bulk transfer”) while its business is still ongoing. In this case, the auction mechanism is a public bid or public auction (to be determined by the court) and the base price cannot be less than the valuation suggested by the auctioneer (based on its market price);³

• in cases when there is no continuation of the company’s business, the assets are auctioned in bulk and may be sold in separate groups if the company is engaged in different activities or based in various locations. The BL does not establish a specific mechanism; therefore the request of base prices is left to the court’s discretion;

• auction on an asset-by-asset basis. No base prices are required; however, the court may fix a valuation and set base prices.

In all cases, the debtor’s employees could try to organize themselves for purposes of acquiring the debtor’s assets.

In any of these cases, the creditors secured with mortgages or pledges will be entitled to collect their claims from the proceeds of the auction of the mortgaged or pledged assets. Any creditor may participate in any of the auction proceedings for the purpose of acquiring the debtor company's assets. If the company is sold while its business is still active, the creditor will be required to post a security bond of 10% of the purchase price offered. In asset-by-asset auctions, no security bond is required.

³ The BL establishes that the sale price cannot be less than the total amount of the claims secured with a mortgage or pledge. If the public bid or auction is unsuccessful, a second public bid or auction will be carried out without a base price and the court will decide on how to allocate the proceeds among the creditors.
Distribution of Proceeds

Upon auction of all the debtor company’s assets, the bankruptcy trustee must file a report detailing the auction proceeds and a plan for final distribution among the registered creditors, considering the preferences set forth by the BL (see “Legal Preferences” below). The debtor company and/or the creditors may file objections to the report within 10 days of its filing. The final distribution of funds should be approved by the court and the creditors should be paid in accordance with the court’s decision.

Legal Preferences

The BL sets the following order of preferences according to which the creditors are to be paid. However, legal preferences may be waived by any creditor in favour of other creditors.

Special Preferences

Creditors accepted by the court with a special preference are entitled to collect their claims from the proceeds obtained in the auction of any asset over which the creditor had a special security, according to the following order of preference:

- creditors for expenses originated in the conservation, administration and liquidation of assets (e.g. legal fees of the trustee and its attorneys; payment of taxes over the company’s assets, etc.). The legal preference is set on such assets. The creditor may ask the court to order payment of these expenses at any time from the moment at which the expenses are due;
- creditors who have the right to withhold certain assets of the debtor company (provided that no other creditor had a previous right on such asset);
- creditors for expenses regarding the construction and development of some of the debtor company’s assets;
- labour creditors for salaries due from the company to employees for six months, and for severance or labour accidents (this preference only applies on the debtor company’s assets located at the site where the employee performed his duties);
- creditors for taxes and contributions on certain assets;
- creditors secured with a mortgage, pledge or guarantee on certain assets, and creditors with bonds secured with special or floating guarantee.

General Preferences

Once all secured creditors with special preference have been paid out, the following creditors are entitled to collect their claims from the proceeds of the debtor company’s assets liquidation:

- labour creditors for salaries due from the company to employees for six months, severance and labour accidents, vacations and any other amount due from the company as a result of a labour relationship (this only applies when it was not possible to collect from the proceeds of the liquidation of the debtor company’s assets located at the site where the employee performed his activities). Labour creditors for salaries are entitled to collect out of 100% of the proceeds of the liquidation and exclude any other secured creditor with a general preference. The rest of the labour creditors with a general preference (except labour creditors for salaries) are entitled to collect their claims out of 50% of the proceeds remaining
once all of the debtor company’s assets are liquidated and all creditors with special preference and with a general labour preference have been paid out. Should their claims exceed 50%, the creditors must collect the unpaid portions of their claims on a pro-rata basis with the unsecured creditors;

- social security and unemployment funds entities;
- tax authorities.

Unsecured Creditors

Once all creditors with special preference and with general preference have been paid, those creditors who do not have any preferences are entitled to collect their claims on a pro-rata basis.

Legal Fees

The legal fees due to the bankruptcy trustee and the intervening attorneys are fixed at the court’s discretion between 4% and 12% of the proceeds obtained from the sale of the company’s assets.

Maintaining the Business

The bankruptcy trustee may keep the business going on an exceptional basis when it is believed that the immediate termination could impair the creditors’ situation. It is usual in Argentina that the workers obtain court approval to incorporate a workers partnership (cooperativa de trabajo) for the purpose of keeping the business as a going concern, thus maintaining their salaries. To keep the business going, the bankruptcy trustee should file a going concern plan, which states:

- the chances of keeping the business as a going concern without assuming new liabilities;
- the advantages of such a plan for the creditors;
- the advantages for third parties;
- the business plan;
- the ongoing commercial agreements that should be maintained;
- a plan for any necessary changes to the company’s structure;
- a list of assistants needed for the management of the business; and
- an explanation of how the expenses and debts are to be paid.

There is no obligation upon the debtor company’s shareholders to contribute to the expenses of the business plan filed by the bankruptcy trustee. Court approval for such a plan will state the term for such continuation, the assets that are to be allocated for such purposes, the staff to be involved, the commercial agreements to be maintained and the information flow required in the future.
Risks and Implications of Bankruptcy

Bankruptcy Extension

According to section 161 of the BL (as amended), in a bankruptcy scenario, bankruptcy can be extended to:

- any individual or corporation who, pretending to be the debtor company, has performed certain acts in his/its own interest and has disposed of the debtor’s assets and rights as if they belonged to him/it, thus committing fraud in detriment of his/its creditors (section 161(1));

- any controlling shareholder of the debtor company, if the controlling shareholder has unduly diverted the debtor company’s interests for its own benefit (or for the benefit of the economic conglomerate), and if both of them are under a unified corporate management (section 161(2)); or

- any other individual or corporation whose assets and debts are commingled with those belonging to the debtor company (section 161(3)).

These are discussed further below.

Section 161(1): “Interest Contrary to the Corporate Purpose”

The interest of the person to whom bankruptcy can be extended under section 161(1) could be defined as one contrary to the debtor company’s interest, that is to say an “interest that is satisfied out of the debtor’s assets”.

Consequently, a contrary interest exists not only when there are losses (actual or future) for the debtor, but also when the debtor’s profits are lower than reasonably expected and profits are allocated to another entity.

With regard to the existence of fraud in detriment of the debtor company’s creditors (as required by section 161(1)), fraud is deemed to exist by virtue of the bankruptcy award.

Section 161(2): “Abuse of Control”

Abuse of control can be invoked if there is enough evidence that the debtor company’s controlling shareholders exercise their control over it only to serve their own interest, with a negative effect on the corporate interest of the debtor company. It is worth pointing out that the debtor’s interest is different from the interest of the debtor’s shareholders, and even more different from the whole economic conglomerate’s interest. The debtor company’s interest lies in its own corporate purpose.

According to section 172 of the BL, unless one of the circumstances described in section 161 arises (which includes abuse of control), the bankruptcy award of one of the legal entities which is a member of the economic conglomerate will not necessarily be extended to the other members thereof. Another element in section 161(2) describes the abuse of control as “unified corporate management”, i.e. the existence of a unique board of directors or the same directors managing both corporations.

Section 161(3): “Commingling of Assets and Liabilities”

The commingling of assets and liabilities exists when it is impossible to differentiate the assets and liabilities of different companies. Some examples of what an Argentine court could take into account to assume the commingling of assets and liabilities are:
• common use (sharing) of revenues not duly recorded in the accounting books;
• joint liabilities without reasonable consideration;
• systematically securing commercial and financial obligations;
• use of a common cash box;
• arbitrary allocation of profits and losses for purposes of balancing income statements or tax accounts;
• granting of mutual loans disregarding repayment ability.

The Bankruptcy Extension Process

Section 164 of the BL provides for specific proceedings for the extension of bankruptcy. These proceedings, called ordinary proceedings (*proceso ordinario*), are long-term, full-knowledge and proof-driven. Ordinary proceedings can be initiated either by the bankruptcy trustee or by any creditor from the date of the bankruptcy award up to six months after the bankruptcy trustee’s filing of the general report in court.4

The court’s decision on bankruptcy extension means the effective adjudication of bankruptcy upon the individual (or corporation) concerned. The bankruptcy extension is effective from the date on which it is pronounced by the court.5 The entire bankruptcy proceedings (the original bankruptcy proceedings plus other extended bankruptcy proceedings) are presided over by the court with jurisdiction over the bankruptcy proceedings corresponding to the corporation holding the largest assets.6

The court’s decision on bankruptcy extension includes the following:

• identification of the bankrupt individual or corporation and, in the case of partnerships, that of partners with unlimited liability;
• an order to record the bankruptcy adjudication, and any injunction on assets ordered therein, in the corresponding registries;
• an order to the bankrupt individual or corporation and to any other third party to deliver all the assets belonging to the bankrupt entity to the appointed bankruptcy trustee;
• an order to the bankrupt individual or corporation to submit to the court: information regarding the registration of the entity in Argentina; a precise explanation of the financial condition of the individual or corporation and the exact date of the suspension of payments; a list of assets and liabilities; a balance sheet, income statement and other accounting documents; a list of all the creditors; and commercial and accounting books;
• a general restriction to make any payments;
• an order to intercept the bankrupt’s mail and to deliver it to the appointed bankruptcy trustee;

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4 The date on which the bankruptcy trustee should file the general report is set by the court upon the adjudication of bankruptcy.
5 Section 171 of the BL.
6 Section 162 of the BL.
Global Restructuring & Insolvency Guide

ARGENTINA

- a request to the bankrupt individual or corporation and its managers to indicate a domicile within the court’s jurisdiction to which any future notices will be served;

- a restriction on the directors traveling abroad. Section 103 of the BL provides that until the filing of the trustee’s general report, bankrupt individuals or directors cannot travel abroad without court’s authorization. This restricted period may be extended for six months;

- the order to sell the bankrupt’s assets and the appointment of a person to be in charge of such tasks;

- appointment of a person in charge of preparing the bankrupt’s inventory; and

- setting a court hearing to appoint the bankruptcy trustee.

Foreign Shareholders’ Adjudication of Bankruptcy

According to the BL, an Argentine court is entitled to declare bankruptcy on a foreign entity’s assets existing within the territory of the Argentine Republic. Moreover, the court is entitled to award the bankruptcy of a foreign entity itself (also having effects on the corporate assets located outside the Argentine Republic). However, such a decision by an Argentine court is open to scrutiny under the corresponding foreign law.

In one particular case, the Supreme Court decided to extend bankruptcy of an Argentine subsidiary to the American and English entities that were members of the same economic conglomerate. Where the debtor company’s bankruptcy is extended to a foreign corporation, the foreign corporation is required to notify the court of any assets in Argentina (e.g. its claims against an Argentine debtor) and the court will administer them (through the bankruptcy trustee) at its sole discretion.

Directors’ Liability in a Bankruptcy Scenario

Under sections 234 and 235 of the BL, the bankruptcy award leads to the automatic disqualification (inhabilitación) of the bankrupt entity, as well as its directors. This disqualification is based on objective (as opposed to subjective – fraudulent or negligent behaviour) parameters, i.e. it is focused on the bankruptcy condition per se, regardless of the originating causes thereof. This is an exception to the legal regime of director liability set forth in Argentine corporations law.

The discharge (discontinuance of the disqualification) of the disqualified party is ordered within a period of one year unless there is a criminal action filed against the director, in which case the disqualification period is extended until the termination of the criminal action.

At the time of the bankruptcy award, the situation of the following two groups must be established:

- those persons who are members of the board of directors at that time;

- those persons who are no longer members of the board of directors at that time.

In the first case, the disqualification of the directors is effective from the date of the bankruptcy award. For directors who have held office since the cessation of payments (the

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7 Depending on the complexity of the case, the trustee’s general report is usually filed between 10 and 12 months after the date of the bankruptcy award.
insolvency date: see above), but on the date of the bankruptcy award are no longer directors, the one-year term of disqualification becomes effective from the insolvency date.9

A disqualified director may not engage in commerce, either on his own account or through third parties. He may not be a manager, administrator, statutory auditor or founder of companies, associations, mutual companies and foundations. He may not hold an interest in companies, nor discharge duties as attorney-in-fact.

Directors must appear before the judge whenever they are summoned to provide explanations about the financial condition of the debtor company. They are under the obligation to furnish the court with any information that may be requested. If a director fails to appear, the judge may seek the aid of public force to have directors appear in court.

As mentioned above, directors must request an authorization to leave Argentina’s national territory from the judge having jurisdiction over the bankruptcy proceedings. Such authorization is granted upon reviewing each particular case unless their attendance is essential to clarify the financial condition of the debtor company. After the submission of the general report by the bankruptcy trustee (normally not less than 10 months to one year after the bankruptcy award date), directors must only apply for an express permission if they were to leave the territory for a period of more than 40 calendar days.

The judge may decide to extend such term for a further maximum six-month period by issuing a relevant judgment. In this event, the judge shall provide detailed support for such decision.

In cases when the bankrupt entity has no assets, the commercial judge remands the case to a criminal court for further investigation.

**Third Parties’ Liability in a Bankruptcy Scenario**

Liability for damages to the bankruptcy estate due to the activity of third parties (directors, managers, attorneys-in-fact, etc.) is set forth in section 173 of the BL. This provision expressly provides that the reproachable behaviour must have caused, facilitated, allowed or aggravated the bankrupt debtor’s financial condition or its insolvency.

Furthermore, the criterion to adjudicate liability is exclusively limited to the “wilful intent” existing at the time the third party facilitated, permitted or impaired the financial condition of the debtor or its insolvency. Arguably, it refers to any tortious act performed in a knowing manner and with an intent to inflict damages on a third party, or on the rights of a third party.

As provided by section 174 of the BL, this liability also applies to such acts that may have been carried out up to one year before the insolvency date, and must be declared and determined in proceedings instituted by the bankruptcy trustee. This action becomes statute-barred after two years from the date of the bankruptcy award and the prior approval of the absolute majority of the unsecured claims which have been acknowledged and declared admissible.

Under section 175 of the BL, the bankruptcy trustee can sue the shareholders of the bankrupt company if they have caused or contributed to the insolvency of the company. This is not applicable if, in its relationship with the bankrupt entity, the shareholder exercised its legal rights as a third party in arm’s-length conditions.

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9 The commencement date of the insolvency must be reported by the bankruptcy trustee in the general report and the interested parties (the directors, etc.) may file objections thereto within a 30-day term. At that stage, they may offer submissions of the relevant evidence, which may be allowed by the court, should it be deemed necessary.
This action under section 175 is similar to the action for bankruptcy extension, although there are greater consequences in the case of bankruptcy extension.

**Bankruptcy Conclusion**

There are three different ways to close bankruptcy proceedings:

- agreement of 100% of creditors (the *avenimiento*);
- total payment of claims; or
- termination of the bankruptcy procedure either through final distribution of proceeds or a total absence of assets to be liquidated. In the latter, the BL presumes the existence of fraud and the commercial judge will request the intervention of a criminal court.

**Argentina**

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Overview and Introduction

Australia has two separate but similar regimes operating in respect of insolvency, one for insolvent individuals and the other for insolvent corporations.

This Guide discusses the various formal insolvency administrations for an insolvent individual or corporation, as well as methods to “turn around” corporations to solvent positions.

In Australia, there appears to be a continuing trend towards interventions before insolvency as well as an increasing proportion of administrations that seek to rescue and rehabilitate the person or the company, both with the aim of providing larger returns to creditors than would otherwise be available if a formal bankruptcy or liquidation regime were put in place.

Applicable Legislation

The insolvency regime in Australia is primarily governed by the Corporations Act 2001 (the “Corporations Act”) and its associated regulations, which provides the legislative framework for corporate insolvencies, and the Bankruptcy Act 1966 (the “Bankruptcy Act”) and its associated regulations, which provides a statutory regime for insolvent individuals.

Additional laws may interact with the administration of an insolvent individual or corporation.

Types of Insolvency Administrations

In personal insolvency, an individual may be subject to any of the following regimes:

- Bankruptcy; or
- Arrangements without bankruptcy (personal insolvency agreements and debt agreements).

A company in serious financial difficulty may be placed into external administration. There are five types of external administrations:

- Receivership;
- Voluntary administration;
- Deed of company arrangement ("DOCA");
- Scheme of arrangement; or
- Liquidation or winding up (including provisional liquidation).

These various types of external administrations may overlap or follow one another. At the successful conclusion of a receivership, voluntary administration, DOCA or scheme of arrangement the company may be able to continue to trade. However, a liquidation is typically a terminal administration, the purpose of which is to deregister the company. It may be the inevitable outcome for a hopelessly insolvent company, regardless of which external administration is first implemented.
Meaning of Insolvency

Both the Corporations Act and the Bankruptcy Act define "solvent" as follows\(^1\):

"A person is solvent if, and only if, the person is able to pay all the person’s debts as and when they become due and payable."

Under both Acts, a person who is not solvent is insolvent.\(^2\) This definition is important because many of the formal insolvency regimes discussed below can be implemented only in circumstances where a company or a person is insolvent or nearing insolvency.

Personal Insolvency

Bankruptcy

Bankruptcy is an insolvency administration for individuals that gives the insolvent individual protection from creditors while allowing for the orderly realisation of assets and a fair distribution to creditors through sequestration of the debtor's estate. It has many similarities to a winding up of a company.

Bankruptcy can be initiated:

- At the request of the debtor (voluntary bankruptcy); or
- At the request of a creditor (involuntary bankruptcy).

Voluntary Bankruptcy – Debtor’s Petition

The most common way for an insolvent individual to become bankrupt is the presentation of his or her own petition (a prescribed form) to the Official Receiver. No application needs to be made to a court. If the petition is accepted by the Official Receiver, the individual becomes bankrupt with effect from the date of acceptance.

Involuntary Bankruptcy – Creditor’s Petition

Creditors of the individual may also apply to the Federal Court of Australia or the Federal Circuit Court of Australia by way of a creditor’s petition to have the individual made bankrupt. The creditor must be owed at least AUD 5,000 by the individual, and the individual must have committed an act of bankruptcy within six months preceding the creditor’s petition being filed. The most common act of bankruptcy relied on by creditors is the failure of the individual to comply with a bankruptcy notice issued at the request of the creditor in relation to a debt that is the subject of a final judgment or order of the court. The individual must comply with the bankruptcy notice within 21 days of it being served on the individual.

If the application is successful, the court will make a sequestration order, making the individual bankrupt and vesting the bankrupt’s estate in a trustee in bankruptcy.

Role of the Trustee in Bankruptcy

The trustee is in a very similar role to that of a liquidator. However, unlike a liquidator, the assets of the bankrupt vest in the trustee. The trustee’s primary roles and duties are to collect, preserve and sell the divisible assets of the bankrupt;\(^3\) assess if the bankrupt should

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1. See s 95A of the Corporations Act and s 5 of the Bankruptcy Act.
2. See s 95A(2) of the Corporations Act and s 5 of the Bankruptcy Act.
3. The assets available exclude certain assets exempted by the Bankruptcy Act but include certain assets acquired by the bankrupt and certain income earned by the bankrupt after the bankruptcy commenced and before the bankrupt is discharged from the bankruptcy.
be making income contributions to the estate; and distribute the available proceeds to creditors in the order regulated by the Bankruptcy Act. A trustee must also investigate the affairs of the individual before he or she was made bankrupt.

Once the distribution of the estate funds (if any) to creditors is complete, the trustee may be released from the estate.

**Termination of the Bankruptcy**

Typically, the bankrupt will be discharged or released from bankruptcy automatically after a period of three years from the date the bankrupt files a statement of affairs. However, the bankrupt may be discharged earlier in certain circumstances.

A discharge operates to release the individual from all debts (except secured debts) that were provable in the bankruptcy.

**Clawback and Recovery Mechanisms (Antecedent Transactions)**

The Bankruptcy Act contains avoidance provisions that enable a trustee to challenge particular transactions that may be considered void against the trustee. The avoidance provisions are similar to those in the Corporations Act.

Below are examples of the transactions that are deemed to be void against the trustee.

- **Undervalued transactions.** A transfer of property by a person who later becomes bankrupt, where the transferee gave no consideration for the transfer or gave consideration of less than market value, and the transfer took place within the five years prior to the commencement of the bankruptcy.

- **Transfers to defeat creditors.** A transfer of property by a person who later becomes bankrupt where the transferor’s main purpose in making the transfer was to prevent the transferred property from becoming divisible among the transferor’s creditors, or to hinder or delay the process of making the property available for division amongst creditors, and the property, had it not been transferred, would have probably become part of the bankrupt estate. There is no time limit.

- **Consideration to a third party.** If there is a transfer of property as described above but instead of the transferee giving consideration to the bankrupt, the transferee gives the consideration to a person other than transferor (a third party), and that third party has not in turn provided consideration to the bankrupt, the trustee may be entitled to recover the benefit from the third party for the benefit of the bankrupt estate.

- **Preferences.** A transfer made by person who is insolvent in favor of a creditor, if the transfer has the effect of giving the creditor a preference, priority or advantage over other creditors, where the transfer took place within the six months prior to the deemed commencement of the bankruptcy (that varies depending on the method by which the bankruptcy commenced).

- **Superannuation contributions made to defeat creditors.** Superannuation or pension funds are generally not divisible among creditors. However, a trustee is entitled to

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4 See s 19 of the Bankruptcy Act for a list of trustees duties and s 134 of the Bankruptcy Act for a list of trustee’s powers.

5 The Australian Government has proposed to reduce the period of bankruptcy from three years to one year as part of a law reform proposal package released on 29 April 2016. As at the date of publication, a consultation process is underway in relation to this proposal.

6 Until the bankrupt files a statement of affairs, the three-year period to automatic discharge will not begin to run. The period may be extended by an objection entered by the trustee in bankruptcy in certain circumstances.
claw back superannuation contributions made by a person who later becomes bankrupt, or superannuation contributions made by a third party for the benefit of a person who later becomes bankrupt, if it can be established that the main purpose of the transfer was to defeat the bankrupt’s creditors, or to hinder or delay the process of making the property available for division amongst creditors, and the property, had it not been transferred, would have probably become part of the bankrupt estate. The transfer must have occurred after 28 July 2006 and regard must be had to the pattern of contributions and whether the contribution was “out of character”.

Priority of Claims

The general rule is that debts provable in a bankruptcy rank equally according to the *pari passu* principle and if the property of the bankrupt is insufficient to meet them in full, they must be paid proportionately. However, this rule is subject to several exceptions. For example, a secured creditor is entitled to priority for the amount of its debt ahead of unsecured creditors. In addition, the Bankruptcy Act affords special priority to particular creditors, including (but not limited to) the trustee, for their reasonable costs and expenses incurred in relation to the bankrupt estate and to employee wages. Creditors who receive special priority (see below) will be paid ahead of unsecured creditors, and any funds remaining will be paid to unsecured creditors proportionately.

Arrangements with Creditors Made Under the Bankruptcy Act

As an alternative to bankruptcy, an insolvent individual may be able to enter into a formal arrangement or compromise with his or her creditors under the Bankruptcy Act that binds all unsecured creditors.

There are two types of formal arrangements:

- Personal Insolvency Agreements ("PIA") (commonly referred to as a Part X agreement); and
- Debt Agreements.

These arrangements are all entered into at the initiative of the individual debtor and bear some similarity to a DOCA in respect of a company, as discussed below. Neither requires that an application be filed with a court.

Personal Insolvency Agreement

An individual may initiate a PIA by providing a controlling trustee (who must be a registered trustee in bankruptcy, a solicitor or the Official Trustee) with:

- A draft PIA that sets out what property and income of the debtor is to be made available to pay creditors and how that property and income will be dealt with; and
- An irrevocable authority to act.7

The controlling trustee then takes control of the individual's property and affairs, investigates his or her property and affairs and calls a meeting of creditors to consider the draft PIA. The controlling trustee must also provide a report to creditors stating whether the interests of creditors would be better served by accepting the proposed PIA or by the bankruptcy of the individual. A meeting of creditors must be held within 25 to 30 business days of the

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7 The provision of an irrevocable authority to act in relation to a PIA amounts to an act of bankruptcy for the purpose of a creditor’s petition.
controlling trustee’s appointment, whereby the creditors vote on whether or not to accept the PIA.

If the PIA is accepted by creditors and executed, the controlling trusteeship ends and the trustee of the PIA takes over, administering the terms of the PIA. The PIA does not affect the rights of secured creditors but otherwise binds unsecured creditors, preventing them from enforcing the debts that are the subject of the PIA.

If the PIA ends successfully, the individual is released from those debts that he or she would have been released from had he or she been made bankrupt. If the PIA is not accepted or is terminated for other reasons, the moratorium on the enforcement of unsecured debts referred to above ends and unsecured creditors may enforce their claims, including by filing a creditor’s petition to bankrupt the individual, or the creditors may resolve to require the individual to present a debtor’s petition for bankruptcy.

**Debt Agreement**

A Debt Agreement is similar to a PIA but less formal and less expensive to implement. It is only available to low-income earners whose debts, income and assets that would be divisible on bankruptcy do not exceed the prescribed limits.

**Corporate Restructuring and Insolvency**

**Insolvency**

Corporate Reorganisation or restructure will often be considered when a company is approaching insolvency or is insolvent.

Broadly, under Australian law:

- A company is insolvent when it is unable to pay its debts as and when they fall due, and this is determined by a cash-flow test rather than a balance-sheet test (although balance-sheet solvency may have some relevance to the assessment);

- Solvency is a question of fact to be decided as a matter of commercial reality in light of the circumstances;

- Support available to the company (for example, from other group companies) and any deferral of payment or compromise agreed to by creditors are relevant considerations to determining solvency on a cash-flow test;

- Directors have a duty to prevent the company from trading while insolvent and, in a liquidation, can be held personally liable for the unpaid debts incurred when the company was insolvent (directors could be held criminally liable for insolvent trading if they acted dishonestly and substantial fines and/or imprisonment may be imposed for a criminal conviction);

- In assessing solvency, regard must be had to both debts that are currently due and payable and to future debts and their timeframes for payment; and

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8 See s 194 for the applicable time limit.
9 Acceptance occurs when, at a meeting of creditors, a special resolution is passed by a majority of creditors in number, who are owed at least 75% in value of the individual’s debts.
10 The giving of the authority, the calling of the meeting of creditors and the termination of the agreement itself are all “acts of bankruptcy” under s 40 of the Bankruptcy Act and can provide a basis for a creditor’s petition.
11 As at 20 March 2016, the debt and asset limit is AUD $109,036.20 and the income limit is AUD $81,777.15.
• In relation to future debts, directors must have reasonable grounds to expect that the company will be able to pay them as and when they fall due – the closer the time for payment, the more certain or probable must the expectation be.

Restructuring Options

Reorganisation or restructure can occur both informally or via formal processes under Australian insolvency laws (generally under Chapter 5 of the Corporations Act) including, typically, voluntary administration followed by a DOCA or, less commonly, through a scheme of arrangement.

Informal Arrangements

These commonly occur by, for example, the company entering into contractual compromise or standstill arrangements with its creditors, usually involving debt rescheduling. Informal arrangements will often be preferred to formal insolvency as they avoid the loss of value that is usually part of a formal insolvency and enhance the prospect of the company continuing as a going concern.

Informal arrangements are more difficult to achieve than formal arrangements because it only requires one creditor to refuse to participate for the arrangement to fail.

Appointment of Investigating Accountant

Before a Reorganisation or restructure occurs, secured creditors may also, under the terms of their security agreement with the company, have the ability to appoint an investigating accountant to review the finances of the company and make recommendations as to ways in which the company could be reorganised to improve its financial position. The investigating accountant will usually be engaged by the company but will also be obliged to provide information to, and owe duties to, the secured creditor. Although the recommendations of the investigating accountant are not binding, in practice, a company wishing to avoid the potential consequences of a breach of the security agreement and/or insolvency is likely to follow at least some of those recommendations.

Voluntary Administration

Overview

The voluntary administration procedure is a short-term insolvency administration designed to maximise the return to creditors by, wherever possible, allowing a company in financial difficulty to continue to trade, so that it can be rehabilitated, be sold as a going concern or, where that is not appropriate, be wound up. There is usually little, if any, court involvement in a voluntary administration.

The voluntary administration process provides a company with a little breathing space during which there is a general moratorium on the enforcement of creditors’ claims (with some limited exceptions). The moratorium provided by the voluntary administration process allows any proposals for a longer-term regime for the company’s continued existence to be considered. Such proposals typically include a plan under which relations with creditors are regulated and debts compromised.

Australia’s voluntary administration procedure has the same aim of rehabilitation as the United States’ Chapter 11, but seeks to achieve this objective in some fundamentally different ways:
The company’s directors are not formally removed but their powers are suspended; during the administration the company is under the control of the voluntary administrator, an independent insolvency practitioner;

The process is creditor-driven rather than debtor-driven, and creditor decision-making is by all creditors voting as a single class; and

A voluntary administration can take place entirely without court involvement.

An important distinction between voluntary administration and US Chapter 11 is that contractual counterparties of a company in voluntary administration are permitted to terminate their contract with the company if a termination right has arisen, as would usually be the case if a voluntary administrator has been appointed.

Proposals received during the voluntary administration period are typically implemented through a DOCA approved by the company’s creditors, which is binding on the company, its shareholders and its creditors.

How is a Voluntary Administration Initiated?

A voluntary administration is usually commenced by the directors of a company resolving that, in their opinion, the company is insolvent or is likely to become insolvent and that an administrator should be appointed. Although less common, a secured creditor or a liquidator of the company may also appoint an administrator in certain circumstances.

The written consent of the proposed administrator (who must be a registered liquidator) is required before the appointment.

Once an administrator has been appointed to a company, the company is required to set out in every public document and negotiable instrument the expression “administrator appointed”.

Role of the Voluntary Administrator

The administrator takes control of the affairs and business of the company, and acts as an agent of the company. The administrator has broad powers, which include carrying on the business or selling assets of the company. The administrator is personally liable for debts incurred by the company continuing to trade post-appointment and has the right of indemnity supported by a statutory lien over the assets of the company.

The powers of the company’s directors are suspended for the administration period.

The administrator must convene two meetings of creditors. The first meeting must occur within eight business days of the administrator being appointed. The first meeting considers if the administrator should be replaced and if a committee of creditors be appointed as an advisory body. The second meeting must occur within 25 business days after the administrator being appointed. The second meeting decides the future of the company, which is discussed in more detail below.

The administration process is intended to be quick, although in more complex administrations (such as of corporate groups), it is usual for the court to extend relevant time limits.

12 Under the Insolvency Law Reform Act 2016 (Cth) (“ILRA”), the committee of creditors will be replaced with a committee of inspection. The ILRA has received royal assent; however, these provisions have not yet commenced. They are not expected to commence until March 2017.

13 This period is extended to 30 business days during the Christmas and Easter period.
The Moratorium

During the limited period over which the administration usually occurs (intended to be around a month for simple administrations), the company has the benefit of a statutory moratorium during which time (and subject to a few limited exceptions):

- Creditors, including secured creditors, are prohibited from taking any action against the company to recover debts, enforce charges or have the company wound up other than secured creditors with a security interest over the whole or substantially the whole of the company’s property who enforce their security within 13 business days;
- Owners or lessors of property that is being used by the company are prohibited from seizing or reclaiming property (although termination notices can be given that take effect after the conclusion of the administration period); and
- Guarantees granted by directors of the company cannot be enforced.

Outcome of the Voluntary Administration

The administrator must investigate the financial situation and affairs of the company and recommend to the company’s creditors whether it is in their interests to:

- End the administration and hand the company back into the control of its directors (which rarely happens and is appropriate only if the company is solvent);
- Enter into a DOCA; or
- Have the company wound up by transition to a creditors’ voluntary liquidation.

The administration ends when creditors resolve at the second meeting of creditors in the administration to end the administration, proceed to liquidation, or on execution of the DOCA.

To be passed a resolution must obtain a simple majority by number and value, with creditors voting as one class. The administrator has a casting vote if only one of the required majorities is obtained.

Deed of Company Arrangement (“DOCA”)

A DOCA is separate from, but necessarily follows, the voluntary administration process discussed above. It commences with the execution of the DOCA approved by the creditors at the second meeting of creditors in the voluntary administration.

A DOCA is a flexible agreement between a company and its creditors that governs the relations between the company and its creditors after the end of the voluntary administration, including the nature and duration of any moratorium period, property available to pay creditors, the scheduling of payments to creditors (usually in accordance with statutory priorities) and the extent of the release of the debts of the company. It is administered by a deed administrator who is usually (but is not necessarily) the same person who was appointed as the voluntary administrator of the company.

The DOCA itself has very few formal requirements and may be moulded to suit the particular circumstances of the company. For example, it may allow the company to trade on, including under the control of its directors. It will generally provide for a fund to be provided for distribution to creditors and incorporate the liquidation provisions for dealing with creditors’ claims (discussed below).
If a company continues to trade on under a DOCA, it is generally required to set out in every public document the expression “subject to a deed of company arrangement”.

The DOCA does not affect the rights of future creditors of the company if it continues to trade and incur debts. As noted below in the commentary on schemes of arrangement, a DOCA is not able to effect releases of claims that creditors may have against third parties.

The regime ends when the DOCA is terminated. If the DOCA is terminated because its aims have been met, the company can continue to trade and is returned to the full control of its directors and officers. However, if the DOCA is terminated other than for that reason, it is likely that the company will proceed to liquidation.

Sometimes, the DOCA will terminate promptly after execution and the creditors’ claims and the assets intended to meet those claims moved to a separate trust, referred to as a creditors’ trust. This is to allow the company to continue to function without strictly remaining subject to a DOCA and the stigma of having to note that it is subject to a DOCA on all public documents.

Schemes of Arrangement

Overview

A company may also be reorganised or restructured through a scheme of arrangement.

Schemes of arrangement have, since the advent of a voluntary administration regime, been more frequently used in the reconstruction or merger of a company or group of companies involving the company’s shareholders rather than its creditors (a “members’ scheme of arrangement”) due to:

- The time and cost involved to implement a scheme of arrangement (particularly given the insolvent trading risk for directors); and
- The ability (since 1993) to achieve the same or similar outcomes more quickly and cost-effectively through the voluntary administration process via a DOCA.

However, schemes of arrangement involving a compromise between a company and some or all of its creditors (a “creditors’ scheme of arrangement”) have recently had a resurgence in popularity.

Two Australian decisions have paved the way for a revival of the use of creditors’ schemes of arrangement where the reconstruction requires the release of third-party claims by creditors of an insolvent company. The High Court of Australia has held that DOCAs cannot give effect to a release by creditors of claims against third parties,14 while the Full Federal Court of Australia has held that in certain circumstances, a scheme of arrangement may be used to achieve that effect.15 Accordingly, there have been a number of creditors’ schemes of arrangement being effected after a company has gone into a formal insolvency, pursuant to which a third party has contributed funds to be available for distribution to creditors in return for releases of that party by creditors, effected by way of a creditors’ scheme of arrangement.

Creditors’ schemes of arrangement have also been used recently to effectuate the substantial debt-for-equity restructurings of the Alinta Energy group of companies, the Centro Property group and the Nine Entertainment Group. Creditors’ schemes of arrangement have also been used recently to effectuate the substantial debt-for-equity restructurings of the Alinta Energy group of companies, the Centro Property group and the Nine Entertainment Group.

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14 *Lehman Brothers Holdings Inc v City of Swan & Ors; Lehman Brothers Asia Holdings Limited (in liquidation) v City of Swan & Ors* (2010) 240 CLR 509.
arrangement are potentially attractive in larger restructurings for a range of reasons, including the greater certainty that a restructure effected with court sanction can bring; DOCAs, by contrast, are more susceptible to being subsequently set aside.

**How Is a Scheme of Arrangement Effected?**

By way of an overview, a creditors’ scheme of arrangement involves:

- The court making orders, on the application of the company, for the convening of meetings of the relevant class or classes of creditors for the purpose of considering the proposed scheme of arrangement (the “first court hearing”). The Australian Securities & Investments Commission (“ASIC”) must be given at least 14 days’ notice of this application in order to give it sufficient opportunity to consider the relevant material;

- The dispatch to the relevant creditors of an explanatory statement containing prescribed information about the scheme of arrangement;

- The holding of the meeting or meetings (“scheme meetings”) of the class or classes of relevant creditors to consider the proposed scheme of arrangement. A creditors’ scheme of arrangement must be approved by a majority of creditors in the relevant class voting, whether in person or by proxy, being a majority whose debts or claims against the company amount in the aggregate to at least 75% of the total debts or claims against the company of the creditors in that class voting, whether in person or by proxy;

- Assuming the requisite approvals are obtained at the scheme meetings, the court making orders approving the scheme of arrangement (the “second court hearing”); and

- The scheme of arrangement becoming effective once the orders approving the scheme are lodged with ASIC.

A scheme administrator, who must be a registered liquidator, will be generally be appointed to give effect to the terms of the creditors’ scheme of arrangement.

**Liquidation**

Liquidation is the procedure by which the affairs of a company are wound up and brought to an end. In Australia, there are three types of liquidation or winding up:

- Compulsory liquidation (including provisional liquidation);

- Creditors’ voluntary liquidation; and

- Members’ voluntary liquidation.

**Compulsory Liquidation (Including Provisional Liquidation)**

A compulsory winding up can only be effected by an order of the court. Creditors of the company and certain other eligible applicants can apply to the court to have the company wound up. The most common ground for a winding-up application is the company’s failure to comply with a statutory demand. If the application is successful, the court will order that the company be wound up and an official liquidator be appointed to it.
In cases where the assets of the company may be at risk, the court can, on an urgent basis, appoint a provisional liquidator after a winding-up application has been filed and before the making of a winding-up order.

**Creditors’ Voluntary Liquidation**

A creditors’ voluntary winding up is initiated by a special resolution of the company’s shareholders. A creditors’ meeting must be held within eleven days of the shareholders’ meeting to confirm the appointment of, or to replace, the liquidator.

**Members’ Voluntary Liquidation**

This method of winding up is available only when the company is solvent and the directors are able to determine that the debts of the company can be paid in full within 12 months of the commencement of the liquidation (and make a declaration to that effect). The winding up commences when the shareholders, by special resolution, vote to wind up the company.

**Role of the Liquidator**

Once appointed, a liquidator takes control of the company from the directors and acts as the agent of the company.

The liquidator’s primary roles and duties are to preserve, collect and sell the assets of the company, and then distribute the available proceeds in the order regulated by the Corporations Act (as discussed further below).

**Clawback and Recovery Mechanisms**

Liquidators have broad powers to investigate the affairs of the company and to take appropriate legal action against directors or third parties to recover certain assets or undo certain transactions for the purpose of increasing the estate available for distribution to creditors. The general acceptance of litigation funding in Australia over recent years has made it easier for liquidators to pursue meritorious recovery actions.

Examples of the recovery mechanisms available are listed below.

- **Insolvent trading.** Under the Corporations Act, directors have a duty to prevent the company from trading while insolvent. If the company incurs a debt while the company is insolvent or becomes insolvent as a result of incurring that debt, and the directors at the time the debt is incurred are aware that there are grounds for suspecting the company is insolvent, or a reasonable person in a like position in the company’s circumstances, would be so aware, those directors will have breached their duty by failing to prevent the company from incurring that debt. There are only limited defences available.

  If a director has been found to have breached this duty, the liquidator may recover from the director, as a debt due to the company, the amount of any loss or damage suffered by an unsecured creditor whose debt was incurred while the company was insolvent. In limited circumstances, the affected creditor can sue for recovery of its loss and damage directly.

  A breach of this duty may result in civil penalty orders against the director/s and may amount to a criminal offence if the director’s failure to prevent the debt being incurred was dishonest.

- **Breach of general directors’ duties.** Directors owe the company a number of general-law and statutory duties including:
(i) Fiduciary duties;
(ii) A duty of good faith;
(iii) A duty to exercise their powers and discharge their duties with care and diligence;
(iv) A duty to exercise their powers and discharge their duties in good faith and for a proper purpose; and
(v) A duty to not use their position improperly or improperly use information gained through their position to gain an advantage for themselves or others, or cause a detriment to the company.

Liquidators may sue the directors for recovery of loss and damage suffered by the company as a result of the breach of these duties. Breaches of the statutory duties may also give rise to civil penalties and, in extreme circumstances, can amount to a criminal offence.

- **Uncommercial transactions.** A company’s uncommercial transaction of the company (which is assessed as uncommercial by reason of, among other factors, the benefits and detriment to the company of entering into it) entered into within two years prior to the deemed commencement of the liquidation is voidable on the application of the liquidator if it was entered into or given effect to at a time when the company was insolvent, or the company became insolvent as a result. The two-year period is extended to four years where the transaction involves a related entity.

  If the payment was entered into or given effect to after the deemed commencement of the winding up but before the actual winding up commenced (i.e. during administration or while the company is subject to a DOCA), and without the authority of the relevant administrator, the liquidator can seek to avoid the transaction without also proving the company was insolvent at the time.

- **Unfair preferences.** A liquidator may seek to recover payments made to unsecured creditors within a period of six months prior to the relation-back day, if:

  (i) Those unsecured creditors have been preferred over other unsecured creditors within that period; and

  (ii) If those payments were made at a time the company was insolvent or the company became insolvent as a result of making those payments. The six-month period is extended to four years where a payment involves a related entity.

  If the payment was made after the relation-back day, but before the actual winding up commenced (i.e. during administration or while the company is subject to a DOCA), and without the authority of the relevant administrator, the liquidator can recover the payment without also proving the company was insolvent at the time.

- **Unfair loans.** An unfair loan made to the company at any time on or before the winding up began is voidable on the application of the liquidator. A loan is considered unfair if the interest or charges on it are extortionate.

- **Transactions entered into for the purpose of defeating, delaying or interfering with rights of creditors.** A transaction entered into at a time the company is insolvent or becomes insolvent as a result is voidable on the application of the liquidator if it was
entered into within ten years of the deemed commencement of the liquidation and the company became a party to the transactions for reasons including defeating, delaying or interfering with the rights of any or all of its creditors on a winding up.

**Unreasonable director-related transactions.** Transactions are voidable on the application of the liquidator to the court if it can be established that the company entered into a transaction (including making a payment or disposing of assets):

(i) During a period of four years ending on the relation-back day or after the relation-back day but before the date the company was actually wound up, if it was entered into without the authority of the administrator or deed administrator;

(ii) With a director or close associate of the director; and

(iii) It may be expected that a person in the company’s circumstances would not have entered into the transaction having regard to the benefits to the company, the detriment to the company and the respective benefits to the other parties.

**Transactions with the intention of avoiding employee entitlements.** Transactions entered into for the purposes of avoiding or reducing payment to employees of their entitlements are prohibited and persons in contravention may be personally liable to compensate the company for any loss or damage that may result.

The last six of the clawback mechanisms discussed above are known as voidable transactions in the Corporations Act. If a court is satisfied that the transaction is voidable, it may make orders including those for the repayment of money or the retransfer of property.

**Priority of Claims and Government Assistance for Employee Claims**

In a winding up, all unsecured creditors with claims (including contingent and future claims, and unliquidated claims) against the company, are entitled to participate for dividend from the available assets in respect of their claim, if the circumstances giving rise to their claim arose before the relevant date. The relevant date is usually the date on which the winding up order was made, or the date of the appointment of the administrator if the winding up was preceded by a voluntary administration.

Claims are submitted to, and adjudicated on by the liquidator in a quasi-judicial capacity, pursuant to the proof of debt procedures specified in the Corporations Act and associated Corporations Regulations. If a proof of debt is rejected in whole or in part, there are appeal rights.

Secured creditors\(^\text{16}\) are entitled to enforce their security interest during the winding up unless it is void as against the liquidator as a matter of law (e.g. if the security interest has not been perfected within the applicable statutory timeframes) or by reason of a court order. Accordingly, subject to the exception that follows, secured creditors will be paid in priority to all other debts to the extent of their security. However, the secured creditor’s claim to assets subject to a circulating security interest – usually cash, receivables, inventory and similar assets – is statutorily subordinated to specified employee claims that qualify for priority in a winding up, being wages and superannuation, leave and redundancy entitlements.

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\(^{16}\) Certain third party owners of personal property (such as suppliers under hire purchase agreements or under retention of title terms) are treated as secured creditors by reason of the Personal Property Securities Act 2009.
Apart from secured creditors, specified priority debts and claims include, in general terms:

- Expenses incurred by an administrator or liquidator in preserving and realising the property of the company;
- The costs and expenses of obtaining the order for liquidation; and
- Specified employee entitlements which include wages, superannuation contributions, leave entitlements, injury compensation and retrenchment payment (although employee claims of directors and their spouses have only limited, capped priority).

The Corporations Act provides for an automatic set-off in winding up where a creditor has a claim it asserts against the company, and the company also has a claim it asserts against the creditor, such that only the net balance will be a claim of or against the company. The set-off will not apply where the claims are not held in the same capacity, or where the creditor had knowledge of the company’s insolvency at the time it gave or received credit to or from the company.

There is also capacity under the Corporations Act for creditors whose claim against the company is insured to obtain any insurance proceeds received by the company in respect of their claim.

All other unsecured debts rank equally according to the *pari passu* principle, and if the property of the company is insufficient to meet them in full, they must be paid proportionately.

The Australian Taxation Office (ATO) no longer has any priority for amounts owing to it, but has significantly enhanced powers to pursue directors for unpaid company taxes and can also pursue directors to recover any amounts it is required to disgorge to the company’s liquidator as unfair preferences (discussed below).

If a third person advances money to the company for the purpose of making a payment to employees in respect of priority entitlements, and that money is applied for that purpose, that person has the same right of priority in respect of the money advanced as the employees would have had in the liquidation had the employees not been paid.

In Australia, the government has established assistance schemes – the General Employee Entitlement and Redundancy Scheme ("GEERS")\(^{17}\) and the Fair Entitlements Guarantee ("FEG")\(^{18}\) – under which employees may be eligible to receive a payment from the Commonwealth Government in respect of specified entitlements up to a maximum amount, if those employees have lost their employment as a result of the insolvency of their employer. GEERS/FEG (as applicable) will then seek to recover those payments in the winding up of the insolvent employer and will have the same priority of payment that the employees would have had in the liquidation had the employees not been paid under GEERS/FEG.

**Receivership**

A receiver may be appointed to a company either by a secured creditor (a “private receivership”) or, in exceptional circumstances, by the court (a “court-appointed receiver”). This summary only discusses private receiverships.

A receiver is appointed by a secured creditor (commonly a lender) pursuant to a security agreement (ordinarily after the company defaults under the security agreement) with powers

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\(^{17}\) GEERS applies to bankruptcies and liquidations which commenced prior to 4 December 2012.

\(^{18}\) FEG applies to bankruptcies and liquidations which commenced on or after 5 December 2012.
to manage, preserve and realise enough of the company’s assets covered by the security in order to discharge the outstanding debt owed to the secured creditor.

The powers of receivers are set out in the security agreement, often called a charge, and the Corporations Act. If the receiver is given the power to manage the affairs of the company in addition to these powers, the receiver will be referred to as a receiver and manager. Receivers are also referred to in the Corporations Act as “Controllers”, a concept that includes mortgagees in possession.

Usually, receiverships will not have any court involvement.

A secured creditor may have a security interest over a company’s circulating assets (e.g. over cash or trading stock), non-circulating assets (e.g. over equipment) or both. A secured creditor may have security interest over a company’s circulating assets (e.g. over cash or trading stock), non-circulating assets (e.g. over equipment) or both. When distributing proceeds of circulating assets, a receiver is obliged under the Corporations Act to pay certain priority employee entitlements claims first before paying the secured creditor.

Once the secured creditor has been paid in full, the receivership terminates.

Conclusions and Additional Observations

Since the voluntary administration regime was introduced in Australia in 1993, it has become the most common formal corporate insolvency mechanism, by reason of its relative speed of implementation and the flexibility of outcome. However, we are seeing a resurgence of creditors’ schemes of arrangement in complex restructurings, and in insolvency scenarios where a third party contributing funds for the benefit of creditors requires releases from those creditors.

There are some features of the Australian corporate insolvency landscape that warrant noting:

- **Directors’ personal liability for insolvent trading as discussed above under the heading “Clawback and Recovery Mechanisms”**: This feature of the Corporations Act is not found in most other insolvency regimes. Directors can also be personally liable for certain unpaid company taxes including the superannuation guarantee charge and to reimburse the Commissioner of Taxation if company tax payments are disgorged as unfair preferences. These potential personal liabilities will often motivate directors to act early to appoint a voluntary administrator and are often criticised as they are perceived to thwart restructuring attempts. Recently, the Australian Government has again raised the possibility of a “safe harbor” defence or carve out being inserted into the Corporations Act. The proposed ‘safe harbour’ defence/carve out would seek to protect directors from personal liability for insolvent trading if they take certain steps to turn around the company (for example, by appointing a restructuring adviser to develop a turnaround plan for the company). As at the date of publication, a consultation process is underway in relation to these proposals.

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19 The new legislative regime comprised in the Personal Property Securities Act 2009 (“PPSA”) commenced on 30 January 2012 and applies to security interests in personal property (as opposed to real property). Amongst other things, it replaces the former concepts of fixed and floating charges with security over circulating and non-circulating assets. However, under the PPSA, a security interest over non-circulating assets is the functional equivalent of the former fixed charge and a security interest over circulating assets is the functional equivalent of the former floating charge.

20 The proposal was made as part of the “Improving bankruptcy and insolvency laws” proposals paper released on 29 April 2016.
• **Status of shareholder claims after the Sons of Gwalia decision.** Prior to the decision of the High Court of Australia in *Sons of Gwalia Ltd v Margaretic* ("Sons of Gwalia"), it was generally accepted that claims of shareholders of companies in external administration that arose by virtue of their shareholding were claims in their capacity as members of the company rather than creditors. Under the Corporations Act, claims of members against the company are postponed until all other creditors have been paid in full. However, in *Sons of Gwalia*, the High Court determined that shareholders’ claims do rank with the claims of unsecured creditors, where the claims arise from alleged misleading or deceptive conduct by the company on which the shareholders relied in purchasing the shares. The Australian Government subsequently passed legislation which reverses the High Court’s decision in Sons of Gwalia and ensures that these types of claims by shareholders are subordinated to the claims of other creditors.22

• **Cross-border insolvency.** Australia adopted the UNCITRAL Model Law in the *Cross-Border Insolvency Act 2008*.  

• **Ipso facto clauses.** Clauses in contracts that terminate or amend the contract by reason of an “insolvency event” occurring are generally enforceable under Australian law. However, the Australian Government has recently proposed introducing legislation which would have the effect of making such clauses void except in certain types of financial contracts, such as swaps. As at the date of publication, a consultation process is underway in relation to this proposal.23

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22 See s 563A of the Corporations Act, effective from 18 December 2010.  
23 The proposal was made as part of the “Improving bankruptcy and insolvency laws” proposals paper released on 29 April 2016.
Overview and Introduction

On 1 July 2010, the Austrian Bankruptcy Reform Act (the “IRÄG 2010”) entered into force. With this reform, the insolvency regime in Austria was considerably changed. Up to that point, the Austrian Insolvency Law was divided into two separate regimes: bankruptcy and reorganisation. Accordingly, commercial entities and private individuals were either subject to the Bankruptcy Act (Konkursordnung) or to the Settlement and Reconciliation Act (Ausgleichsordnung). This dual system has now been replaced by a unitary system: the insolvency proceedings (Insolvenzverfahren) under the Insolvency Proceedings Act (Insolvenzordnung).

The aim of this Guide is to give an overview of the insolvency regime and to highlight the significant changes to bankruptcy and reorganisation proceedings brought in by the IRÄG 2010.

Applicable Legislation

Insolvency Act

The insolvency regime in Austria is primarily governed by the Insolvency Proceedings Act (the “Insolvency Act” or “IA”), which provides the legislative framework for bankruptcies and reorganisations of commercial (legal) entities and private individuals. With respect to legal entities, both limited and unlimited partnerships, companies and − according to the Austrian Supreme Court − even municipalities are subject to insolvency proceedings.

Business Reorganisation Act

Besides the Insolvency Act, the Business Reorganisation Act of 1997 (UnternehmensReorganisationsgesetz; the “Business Reorganisation Act”) governs the reorganisation of businesses. Since it is applicable only to certain cases of reorganisation and, in particular, since it lacks to a very large extent any practical relevance, this act is not covered in this Guide.

Insolvency Act

Background

As mentioned above, on 1 July 2010 the IRÄG 2010 entered into force. Its main purposes are to simplify the legislative framework as such, to facilitate the initiation of insolvency proceedings, to accelerate decisions on the opening of insolvency proceedings and to reduce the number of cases in which insolvency proceedings cannot be opened in the absence of sufficient funds. Furthermore, the uniform structure of one single type of insolvency proceeding − instead of (as existed previously) a dual structure of bankruptcy and restructuring − makes it possible to achieve different aims in one single proceeding (see below for further details).

Meaning of the Term “Insolvency”

Under both the former Bankruptcy Act and the currently effective IA, the opening of insolvency proceedings requires either the “illiquidity” (section 66 of the IA) or the “over-indebtedness” (section 67 of the IA) of the debtor. While section 66 is applicable to any debtor, under section 67 insolvency proceedings in cases of over-indebtedness can only be initiated for legal entities, estates or registered partnerships without a personally liable
partner. For initiating proceedings for restructuring, it is also sufficient if the illiquidity of the debtor is not already existent but is impending (section 167(2) of the IA).

The IA does not provide for a definition for the terms “illiquidity” or “over-indebtedness”. The terms have been substantiated by case law as follows:

“A person is deemed illiquid when this person due to a lack of available funds is not able to pay its due and payable debts and the debtor will not be in the position to gain sufficient funds shortly.”

“A company is deemed over-indebted if payable and non-payable receivables together exceed all assets of the debtor and the prospect for the company’s going concern is negative.”

Under these preconditions, insolvency proceedings may be initiated at the request of either the debtor or the creditor.

Corporate Insolvency

Whilst the following overview is predominantly related to corporate insolvency, the specific regulations for private insolvency are also outlined below.

Debtor’s Petition

Upon voluntary petition of the debtor to the insolvency court, the insolvency proceedings have to be immediately opened. In cases of illiquidity or over-indebtedness, the debtor is obliged to apply for the opening of insolvency proceedings without culpable delay, but in any event not later than 60 days after the occurrence of the debtor’s illiquidity and/or over-indebtedness within the meaning of the IA. If the debtor, and/or the management of the debtor where the debtor is a corporation, ignores this obligation, they will become personally liable to the creditors for all damages arising as a consequence of the delayed application to the insolvency court. If the corporation is without management (for example, due to revocation, withdrawal or death of its members), the obligation to apply for the opening of insolvency proceedings passes on to the corporation’s majority shareholders (i.e. shareholders with a stake of more than 50% in the corporation).

Creditor’s Petition

Creditors are also entitled to apply for the opening of insolvency proceedings. The creditor is required to provide *prima facie* evidence that, firstly, he has a claim against the debtor and, secondly, that the debtor is illiquid. The claims of the particular creditor applying for the opening of insolvency proceedings need not be payable at the time of the application.

Opening of the Insolvency Proceedings

The insolvency court has to assess whether the conditions for the opening of the proceedings are fulfilled. Also, in cases where the application has been withdrawn by the creditor, the insolvency court will continue with this assessment as the withdrawal alone does not suffice to rebut the debtor’s illiquidity. The debtor has the right to comment on the creditor’s application for the initiation of insolvency proceedings. The insolvency court is obliged to open the insolvency proceedings if it comes to the conclusion that the debtor is in fact either illiquid or over-indebted. Upon its decision to commence insolvency proceedings,
the insolvency court will publish its decision in the publicly accessible insolvency public register (Insolvenzdatei), available at www.edikte.justiz.gv.at. Where a company is subject to insolvency proceedings, the competent commercial court will also be notified and an entry made in the company’s register.

In cases where the assets of the debtor are insufficient to cover the costs of the insolvency proceedings, the insolvency court may reject the opening of insolvency proceedings. This decision also has to be published in the online insolvency register (Insolvenzdatei: www.edikte.justiz.gv.at).

**Insolvency Proceedings**

The insolvency proceedings can be opened as either restructuring proceedings (Sanierungsverfahren) or bankruptcy proceedings (Konkursverfahren). When restructuring proceedings are opened and there is no prospect of success for the reorganisation of the debtor, the proceedings will be continued as bankruptcy proceedings.

**Restructuring Proceedings and Restructuring Plan**

There are two main differences between bankruptcy proceedings and restructuring proceedings. First, restructuring proceedings are not foreseen for the insolvency of natural persons who are not operating a business (“private insolvency”). Furthermore, in bankruptcy cases, the insolvency court deprives the debtor completely of its legal powers to act on its own behalf, appointing an insolvency administrator to act on behalf of the insolvency estate. Restructuring proceedings, however, may be opened either as restructuring proceedings with no self-administration or as self-administered restructuring proceedings. In case of restructuring proceedings with no self-administration, an insolvency administrator will be appointed, too. In case of self-administered restructuring proceedings, however, the debtor will not be completely deprived of its powers, but will be able to self-administrate the proceedings under the supervision of a restructuring administrator.

In order to open the insolvency proceedings as restructuring proceedings, the debtor has to – prior to the opening of the proceedings – elaborate a restructuring plan. The main purpose of this plan is to find a compromise between the debtor and the creditors, in particular on the quota that will be eventually distributed to the creditors within a given period. In this respect, the quota at which the debts must be settled in restructuring proceedings with no self-administration has to amount to at least 20% and has to be paid within a period of two years. By contrast, in case of self-administered restructuring proceedings, the settlement to be achieved within the two-year period has to amount to at least 30%. If no restructuring plan is presented prior to the opening of the insolvency proceedings, the proceedings will be opened as bankruptcy proceedings.

The restructuring plan has to be accepted by the creditors. In this respect, two voting requirements have to be fulfilled. Firstly, the restructuring plan has to be accepted by the majority of the creditors present at the court hearing. Secondly, of those creditors present at such court hearing, the accepting ones have to represent the majority of the notified claims. If the creditors reject the restructuring plan within 90 days of the opening of the proceedings, the insolvency court is obliged to revoke the self-administration and appoint the insolvency administrator to act on behalf of the insolvency estate.

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5 See section 167 of the IA.
6 See section 180 of the IA.
7 See section 167, paras 2 and 3 of the IA.
8 See section 80 of the IA.
9 See sections 140, 141, 167 and 169 of the IA.
Bankruptcy Proceedings

If bankruptcy proceedings have been initiated, the insolvency court in any event appoints an insolvency administrator. As of this appointment, every legal action concerning the insolvency estate must be executed only by the insolvency administrator, and the debtor is prohibited from disposing of its assets. The responsibilities of the insolvency administrator are as follows:

- To clarify the financial situation of the debtor as well any guarantees given by third persons in favour of the debtor;
- To assess immediately after his appointment whether the business of the debtor can be continued or reopened (if already closed);
- To assess whether reorganisation is in the interest of the creditors and if a reorganisation plan is likely to be implemented; and
- To appraise the insolvency estate and administrate any outstanding legal actions.

Please note that in the course of bankruptcy proceedings, it is also possible to apply for the conclusion of a restructuring plan. As for restructuring proceedings with no self-administration, the quota offered has to amount to at least 20% and the repayment period must not be longer than two years. In cases of natural persons other than entrepreneurs, the repayment period must not exceed five years. The acceptance of the restructuring plan will not, however, lead to a renaming of the bankruptcy proceedings as restructuring proceedings; the insolvency proceedings will be continued as bankruptcy proceedings. If no restructuring plan is accepted within one year after the opening of the insolvency proceedings, the insolvency court has to order the closure of the debtor’s business in order to protect the creditors’ interests. The insolvency administrator may apply for an extension of this deadline for another year; however, in total, the insolvency court may not grant an extension period longer than two years.

Contractual Relationships

In general, contracts entered into by the debtor remain unaffected by the opening of insolvency proceedings. However, the insolvency administrator has the option to either fulfil the debtor’s obligations under the contract or withdraw from the contract within a time period set out by the insolvency court.

Furthermore, special provisions for rent agreements, employment contracts and contracts with a fixed deadline for the performance of the agreed obligations have to be observed.

It has to be noted that an agreement according to which a party has the right to withdraw from a contract or according to which the contract will be dissolved due to the initiation of insolvency proceedings against the other party is invalid under Austrian Insolvency Law (section 25b of the IA). The counterparty will remain bound by the terms of the relevant contract. Furthermore, within six months of the opening of the insolvency proceedings, contracts that are considered necessary for the continuation of the debtor’s business can be terminated by the creditor only due to a material cause (section 25a of the IA). In this respect, neither the deterioration of the economic situation of the debtor nor the failure of the debtor to settle claims that became due prior to the opening of insolvency proceedings is

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10 See section 80 of the IA.
11 See section 140 of the IA.
12 See section 141 of the IA.
13 See section 115, para 4 of the IA.
deemed to constitute a material cause. However, the restrictions on the termination rights of the creditor pursuant to section 25 of the IA will not apply if the termination of the contract is indispensable for the avoidance of severe personal or economic disadvantages for the creditor.

Clawback and Recovery Mechanisms (Antecedent Transactions)

The basic principle of the insolvency regime is to ensure the equal treatment of all creditors. The aim of the legal regulations on clawbacks and recovery mechanisms is to remedy disadvantages suffered by the creditors due to the debtor’s transfer of assets to third parties before the insolvency proceedings have been opened. Legal acts that intend to discriminate against certain or all of the creditors may be appealed by the insolvency administrator and annulled by the insolvency court.

A transaction may be avoided *inter alia* under the following circumstances.

**Intentional Discrimination of Creditors**

Under section 28(1) and (2) of the IA, the insolvency administrator is entitled to avoid transactions by the debtor if such transactions were entered into by the debtor with the intent (*Absicht*) to harm its creditors, provided that the other party was aware or at least negligently unaware of this intent. If the other party was aware of the debtor’s intent, transactions entered into within the last 10 years prior to the opening of insolvency proceedings may be avoided; if the other party was negligently unaware of such intent, transactions entered into within the last two years prior to the opening of insolvency proceedings may be avoided. Furthermore, according to section 28(4) of the IA, the insolvency administrator is entitled to avoid purchase, swap and distribution agreements that were entered into by the debtor in the year prior to the opening of insolvency proceedings if the other party was aware of or must have been aware of a creditor-harming dissipation of funds.

**Transactions for No Consideration**

Under section 29(1) of the IA, the insolvency administrator is entitled to avoid transactions for no consideration entered into by the debtor if such transactions were entered into in the two years prior to the opening of insolvency proceedings.

**Transactions Favourable for One Creditor**

Under section 30(1) of the IA, the insolvency administrator is entitled to avoid transactions made after the insolvency of the debtor, or after the application for the opening of insolvency proceedings, or 60 days prior to the insolvency of the debtor or the application for the opening of insolvency proceedings, provided that such transactions gave, or made possible, to an insolvency creditor security or satisfaction to which such creditor had no right or no right to claim in such manner or at such time. An avoidance under section 30(1) of the IA further requires that the transaction to be avoided was entered into in the year prior to the opening of the insolvency proceedings.

**Knowledge of the Insolvency**

Under section 31(2) of the IA, the insolvency administrator is entitled to avoid transactions made after the debtor has become insolvent or after an application for the opening of insolvency proceedings has been filed with the competent court, provided that (i) the transaction gave, or made possible, to an insolvency creditor security or satisfaction or (ii) the transaction was entered into by the debtor with another person to the direct detriment of the creditors. Furthermore, both cases require that the other party to the transaction was aware of or must have been aware of a creditor-harming dissipation of funds.

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14 See section 37 of the IA.
or reasonably should have been, aware of the fact that the debtor was insolvent or that an
application for the opening of insolvency proceedings had been filed.

Under section 31(3) of the IA, the insolvency administrator is entitled to avoid transactions
made after the debtor has become insolvent or after an application for the opening of
insolvency proceedings has been filed with the competent court, provided that (i) the
transaction was entered into by the debtor with another person to the detriment of the
creditors, (ii) the other person was, or reasonably should have been, aware of the fact that
the debtor was insolvent or that an application for the opening of insolvency proceedings had
been filed, and (iii) the detriment to the insolvency estate was objectively foreseeable. In this
respect, the law stipulates that the detriment was objectively foreseeable if, for instance, it
was obvious at the time that the presented restructuring plan was inadequate.

An avoidance under section 31 of the IA further requires that the transaction to be avoided
was entered into within the last six months prior to the opening of the insolvency
proceedings.

Distribution

The IA provides for a certain settlement order depending on the legal basis of the individual
creditor’s claim. It distinguishes between four different kinds of claims, listed below in order
of priority.

Claims based upon In Rem Rights

Creditors holding in rem rights such as mortgages, liens, reservation of title, or even claims
based on security assignments, may claim for the exclusion of these assets. They take
priority over the unsecured claims in the settlement process. The remaining assets are
distributed among the creditors.

Preferential Claims

Preferential claims are listed exhaustively in section 46 of the IA. Such claims are, for
instance: the administrative costs of the insolvency proceedings; claims of employees of the
debtor for salary; claims of the debtor’s social insurance; and all claims substantiated by acts
of the insolvency administrator during the operation of the debtor’s business. Preferential
claims have to arise during the insolvency proceedings and serve the continuation of the
debtor’s business, which is the main justification for their preferential treatment. Preferential
claims have to be settled by the insolvency administrator out of the funds available first
(i.e. prior to any lower ranking claims) and in full, unless the insolvency estate lacks sufficient
funds. In that case, a specific order of priority in relation to preferential claims applies.

Claims Provable in Insolvency Proceedings

All claims of creditors which were in existence at the time of the opening of the insolvency
proceedings fall under this category. Such claims will be settled only after assets serving as
security for other creditors have been excluded from the insolvency estate and preferential
claims have been settled. All of these claims are treated equally and settled pro rata
(Konkursquote) in proportion to the aggregate amount of all claims notified to the insolvency
court and accepted by the insolvency administrator in the insolvency proceedings.

Lower-ranking and Excluded Claims

Lower-ranking claims are shareholder claims that are treated as equity of the debtor within
the meaning of the Equity Substitution Act (Eigenkapitalersatzgesetz). If the shareholder has
granted a loan to the debtor, and the debtor is in financial crisis, this loan is deemed as
equity of this company (Eigenkapitalersatz). A financial crisis exists if the company is over-
indebted or unable to pay its debts, or the debt-to-equity ratio is below 8% and the notional debt repayment period is more than 15 years. These claims will be satisfied only after all the other claims above have been settled. In contrast, excluded claims are excluded entirely from the settlement.

Termination of the Insolvency

Insolvency proceedings are generally terminated after various hearings, in particular: the examination hearing (Prüfungstagsatzung), at which claims of the creditors are acknowledged or rejected; the reporting hearing (Berichtstagsatzung), at which a decision is made on further proceedings; and the distribution hearing (Schlussverteilung), at which the remaining assets of the debtor are distributed among the creditors.

Private Insolvency

Since 1995, both companies and individuals have been able to request the opening of insolvency proceedings. The IA provides specific provisions on insolvency proceedings for natural persons (including entrepreneurs and non-entrepreneurs). These specific provisions on private insolvency proceedings are outlined below.

Opening of Private Insolvency Proceedings

In contrast to the insolvency proceedings for companies, the insolvency court is not entitled to reject the opening of private insolvency proceedings where the assets of the debtor are not sufficient to cover the costs of the proceedings. In such cases, the debtor must:

- Provide a list of assets confirming that the list covers all assets and obligations;
- Provide for an adequate payment plan;16
- Confirm that his assets will cover the costs of the insolvency proceedings; and
- If the debtor is not an entrepreneur, substantiate that an out-of-court settlement has failed or would have failed.

Debt Settlement Procedures

Under the IA, private insolvency proceedings for individuals other than entrepreneurs are given the special name “debt settlement procedures” (Schuldenregulierungsverfahren). In debt settlement procedures, the debtor is generally entitled to manage its assets on his own behalf (Eigenverwaltung). Only if the insolvency court comes to the conclusion that the debtor is not in a position to manage his assets, or the financial circumstances are unclear, or the debtor does not provide a detailed list of assets, may the court appoint an insolvency administrator.

Payment Plan

The debtor may request the acceptance of a payment plan not only at the opening of private insolvency proceedings17 also during the insolvency proceedings.18 This plan is comparable to a restructuring plan; however, the court hearing on its acceptance may only take place after the realization of the debtor’s disposable assets. The aim of the plan is to find a compromise between the insolvent debtor and the majority of his creditors so that the

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15 See section 181 ff of the IA.
16 See “Payment Plan” below.
17 See “Opening of Private Insolvency Proceedings” above.
18 See section 193 of the IA.
creditors agree on a certain quota. The quota has to be paid within five years, or within seven years in specific cases.

Proceedings of Absorption and Discharge of Residual Debt

If the disposable assets of the debtor have been realized and the payment plan has not been accepted, the insolvency court may start absorption proceedings (Abschöpfungsverfahren mit Restschuldbefreiung) on request of the debtor. The debtor must assign a sizable amount of his income to a trustee for seven years. The trustee is then obliged to settle the creditor’s claims in the given order. During these proceedings the debtor’s income is reduced to a minimum living wage. If the debtor is unemployed, he has to accept any reasonable employment opportunity. If the debtor can satisfy either at least 50% of the claims within a period of three years, or at least 10% of the claims within the whole period of seven years, the insolvency court may release the debtor and discharge the remaining debts. If the debtor is unable to meet these requirements, the court may - depending on the settlement actually achieved - do any of the following: (i) discharge the remaining debts, nonetheless; (ii) adjourn its final decision for a period of three years and determine the extent to which the outstanding debts have to be settled by the debtor during this period; (iii) prolong the repayment period for a term not exceeding three years; or (iv) not grant residual debt discharge. In the last case, all unsettled debt, including late interest, becomes directly collectable by the creditors.

Conclusion and Additional Observations

The latest major amendment to the Austrian insolvency laws took place in 2010. The goal of the IRÄG 2010 was to simplify insolvency proceedings and, beyond that, to facilitate the going concern of companies as well as their restructuring. Furthermore, the new regulations focus on the concept of self-administration.

According to several statistical sources, private insolvencies were constantly increasing in Austria until 2011, whilst company insolvencies were on the decrease. In 2012, however, the development slightly shifted, leading to the number of private insolvencies decreasing, while the number of company insolvencies increased. In 2013, both, the number of private insolvencies as well as the number of company insolvencies decreased, by approximately 5 and 10%, respectively. However, due to the insolvency of a major Austrian construction company, the total amount of company debt increased by about 100%. This amount, in absolute figures, represents a peak in Austrian insolvency history so far. In 2015, the number of company insolvencies continued to decrease by approximately 5%, while the number of private insolvencies (after having decreased in 2014 by approximately 7%), increased by approximately 5%.

Finally, it is worth noting that since Austria is a member state of the EU, the European Regulation on Insolvency Proceedings (EU-Insolvenzverordnung) is applicable and must be taken into consideration in cases of cross-border insolvency proceedings.
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Azerbaijan

Overview and Introduction

Azerbaijan has two separate insolvency regimes: one for non-bank companies and private entrepreneurs; and another for banks. This Guide discusses both regimes. Although independent Azerbaijan’s first insolvency act was adopted in 1994, to date there have been few insolvency or restructuring proceedings.

Applicable Legislation


Insolvency of Non-Bank Companies

Bankruptcy Proceedings

Under the Insolvency Law, an insolvent entity (debtor) itself or its creditors may commence bankruptcy proceedings by filing an insolvency application with a court. In “exceptional” cases, the debtor may commence non-judicial bankruptcy proceedings. The Insolvency Law, however, does not indicate what constitutes an “exceptional” case and, in practice, it appears that this provision is rarely, if ever, used.

In the event of the commencement of bankruptcy proceedings in court, after the court schedules the first hearing, the applicant must publish two notices of the hearing at least seven days before the scheduled hearing date. The court may also require notice to be given to creditors by other means.

In the event of the commencement of non-judicial bankruptcy proceedings, the debtor must give notice to all creditors of the first meeting of creditors. The creditors’ meeting must be held within three weeks of the debtor’s resolution to commence bankruptcy proceedings. Notice of the meeting must be sent to all known creditors by registered mail not later than two weeks before the meeting and published twice in an official periodic publication, with the second notice published not later than one week before the meeting.

An entity is deemed insolvent if it: did not satisfy a legitimate creditor claim within two months of the claim; is not able to make payments required by law; or is not able to pay its debts as they fall due. An insolvent entity may submit a bankruptcy application to a court pursuant to a resolution of the entity’s management body.

After consideration of the case, the court may issue a resolution:

• Declaring the debtor insolvent and appointing a bankruptcy trustee;

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1 The Insolvency Law uses the words “insolvency” and “insolvent” with respect to a debtor and its status (e.g. insolvent debtor, debtor’s insolvency) and “bankruptcy” with respect to procedural issues (e.g. bankruptcy proceedings, bankruptcy application).
• Appointing a temporary bankruptcy trustee or prolonging such appointment; or

• Refusing to declare the debtor insolvent.

After a debtor has been declared insolvent, the bankruptcy trustee convenes the initial meeting of creditors by giving notice to all known creditors of the debtor. The meeting must be held within 15 days of the court’s insolvency resolution.

Upon commencement of bankruptcy proceedings, i.e. the filing of a bankruptcy application with a court or adoption by the debtor of a resolution on commencement of non-judicial bankruptcy proceedings, the debtor may not dispose of any assets for its commercial activity, to fulfil its obligations, or for any other reason without the prior authorisation of the court, bankruptcy trustee or temporary bankruptcy trustee.

Upon the court’s insolvency declaration, claims against the debtor may be asserted only within the framework of bankruptcy proceedings. At any time during the bankruptcy proceedings, the debtor may request that the court suspend the proceedings and consider a rehabilitation plan. A court-approved rehabilitation plan may not exceed two years.

Cherry-Picking

The court-appointed bankruptcy trustee is authorised to represent the debtor and manage its estate. He is given discretion to endorse the debtor’s profitable contracts (making them effective) and to terminate the debtor’s unprofitable contracts. Although a bankruptcy trustee is vested with this “cherry-picking” power, any termination of the debtor’s unprofitable contracts must be made in compliance with the requirements of Azerbaijani law. Specifically, the Insolvency Law allows a creditor whose contracts with the debtor have been terminated by the bankruptcy trustee to assert a claim for the damages caused by termination. The creditor, however, is treated as an unsecured creditor.

Priority of Claims

In the event of liquidation in bankruptcy, the debtor’s assets are distributed in the following order of priority:

• Costs associated with conducting the bankruptcy proceedings (including notice publication, court and bankruptcy trustee expenses);

• Claims of the debtor’s workers for injury or death during working hours;

• Claims of the debtor’s workers for allowances, benefits and wages for the six-month period prior to the insolvency declaration;

• Claims for local and state taxes and payments for mandatory state insurance for one year prior to the announcement of insolvency; and of credit institutions and non-residents related to unsecured loans and interest thereon;

• Claims of other unsecured creditors;

• Claims of the debtor’s owners.

Secured creditors may obtain satisfaction of their claims outside bankruptcy proceedings and, therefore, do not feature in this waterfall.

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2 A temporary bankruptcy trustee may be appointed by the court prior to declaration of the debtor’s insolvency as an interim measure, to ensure that the debtor does not illegally dispose of assets prior to a declaration of insolvency, and conduct an initial financial analysis of the debtor’s financial situation.
Claims submitted after the expiration of the period established for submission are only paid after the satisfaction of timely claims. Claims with a higher priority must be satisfied in full before lower ranking claims may be paid. In the event that the proceeds from the sale of the insolvent debtor’s assets are insufficient to satisfy all claims of equal priority, all claims with the same priority are satisfied pro rata. Claims not paid due to the insufficiency of funds are deemed extinguished, except where the insufficiency is caused by the debtor’s illegal actions or unnecessarily concluded contracts. The assets of a debtor remaining after all creditors’ claims are paid are distributed to the debtor’s owners.

Secured Claims

A secured creditor may satisfy its claims outside bankruptcy proceedings by reclaiming the property subject to its security interest within 14 days of actual notice of such proceedings. If it fails to do so, however, the secured property is included in the debtor’s estate and the secured creditor may only seek satisfaction of its claims on an equal footing with general unsecured creditors.

A claim to recover secured property must be submitted to the bankruptcy trustee. At the secured creditor’s option, the bankruptcy trustee must satisfy the secured claim by:

- Selling the collateral at auction or by other means, and paying the secured claim from the proceeds;
- Transferring ownership of the collateral to the secured creditor; or
- Selling the collateral to a third party as directed by the secured creditor.

Set-Off

If it is discovered during the bankruptcy proceedings that the debtor owes or will owe unpaid debts to another person as a result of transactions entered into before the declaration of the debtor’s insolvency, and that such other person has existing, future or conditional debt obligations to the insolvent debtor, then such mutual debts are set off if such debt obligations were incurred before the commencement of bankruptcy proceedings and are expressed in a monetary amount or have a monetary equivalent. If it is not possible to precisely determine the money equivalent of a debt or debt obligation, the equivalent is estimated by the bankruptcy trustee. Such satisfaction of claims by set-off is subject to the order of priority set out above.

Clawback

A bankruptcy trustee may apply to a court to invalidate the debtor’s transfer of property, including money and securities, if:

- The transfer or pledge of property occurred while the debtor was insolvent;
- The transfer or pledge of property occurred within 90 days prior to the commencement of the bankruptcy proceedings; or
- The creditor is a related party and the transfer or pledge of property occurred within one year prior to the commencement of the bankruptcy proceedings.

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3 Related parties of a borrower are: any legal entity owning or controlling 25% of the debtor’s capital; any subsidiary, branch or representative office of the borrower; any director of the borrower, including any person removed from the management of the debtor within one year prior to the commencement of the bankruptcy proceedings; or a partner in any form of partnership.
Insolvency of Banks

Temporary Administration Imposed by the Central Bank

The Central Bank of Azerbaijan (the “CBA”) must commence temporary administration in respect of a bank if:

- The aggregate capital of the bank falls to 25% or less of the minimum aggregate capital established for banks by the CBA, or its adequacy ratio falls to 3% or less;
- The bank is not able to pay its obligations as they become due;
- An application is made for the commencement of bankruptcy proceedings against the bank; or
- The bank’s license is revoked on the grounds specified in the Banking Law.

Additionally, the CBA has the right to impose a temporary administration in a number of other cases, including the bank’s breach of prudential requirements, requirements of the Banking Law or normative acts of the CBA, and non-compliance with the limitations set out in the bank’s licence. A temporary administrator appointed by the CBA substitutes for all governing bodies of the bank for the period of the temporary administration (up to one year with a possible extension of up to six months) and, among other things, has the right to:

- Consent in writing to transactions on behalf, or for the account, of the bank (in the absence of which such transactions are invalid); or
- Terminate or amend the bank’s agreements, considering the bank’s investment, and alter commission fees and interest and their periods in the bank’s agreements.

However, subject to general civil law grounds for invalidating agreements, there is nothing in the Banking Law which would grant a temporary administrator the right to terminate or invalidate, or apply to a court or other authority for termination or invalidation of, the bank’s other agreements.

During a bank’s temporary administration, upon the CBA’s application, a court may impose a moratorium on the bank’s discharge of its payment obligations.

Bankruptcy Proceedings

A court may commence bankruptcy proceedings in relation to a bank on any of the following grounds:

- The CBA determines that the bank’s aggregate capital is less than 25% of the minimum aggregate capital established for banks by the CBA, or its adequacy ratio is below 3%;
- The bank is not able to fulfill its financial obligations when they become due; or
- The bank is not able to fulfill its outstanding financial obligations when they are demanded by creditors.

Upon the court’s declaration of a bank’s insolvency, a liquidator is appointed for the bank.
Priority of Claims

The assets of an insolvent bank are distributed among its creditors in the following order of priority:

- Subrogation claims of the Deposit Insurance Fund;
- Costs and expenses of bankruptcy proceedings, including remuneration of a temporary administrator and liquidator;
- Claims of employees for damage to health or life sustained during work;
- Claims of employees and former employees in connection with allowances and wages payable for a period not longer than six months prior to a court’s declaration of the bank’s insolvency;
- The bank’s obligations in connection with a temporary administrator’s management and financial rehabilitation proceedings;
- Mandatory payments to the budget and mandatory state social insurance payments for a period not longer than one year prior to a court’s declaration of the bank’s insolvency; and
- Claims of unsecured creditors.

Claims with a higher priority must be satisfied in full before lower ranking claims may be paid. In the event that the bank’s funds are insufficient to satisfy all claims with equal priority, then all claims with the same priority are satisfied pro rata.

Claims of secured creditors are satisfied outside the order of priority at the expense of funds realised from the sale of collateral. Secured claims not satisfied in such fashion are satisfied in the order of priority set out above.

Set-Off

Mutual claims between an insolvent bank and its creditors may be set off, subject to the order of priority set out above. The Banking Law prohibits the set-off of a bank’s illegally incurred obligations and claims and obligations arising after a court’s decision on commencement of bankruptcy proceedings. Unlike the Bankruptcy Law, the Banking Law does not establish the terms of set-off; accordingly, a court may apply the general rules applicable to set-offs as set forth in the Civil Code.4

No Clawback

The bankruptcy chapter of the Banking Law, unlike the Bankruptcy Law, does not contain a provision on invalidation of a bankrupt bank’s agreements or transfer of property which occurred prior to the commencement of bankruptcy proceedings. Therefore, subject to the general civil law bases for invalidating agreements, a bank liquidator would not be able to terminate or invalidate, or apply to a court or other authority for the termination or invalidation of, the bank’s agreements.

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4 Under section 540 of the Civil Code of the Republic of Azerbaijan dated 28 December 1999, outstanding counterclaims between two parties may be terminated by set-off. Set-off is also possible if a claim of one of the parties is not yet outstanding but that party agrees to the set-off. Thus, the requirements for set-off are that the counterclaims be mutual and outstanding.
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Belgium

Overview and Introduction

This chapter gives a short overview of three restructuring and liquidation proceedings under Belgian law: bankruptcy, judicial administration and voluntary liquidation.

Bankruptcy proceedings are conceived as a way to liquidate the business of the company (either as a going concern or by selling the assets piece by piece) with a view to paying the debts of the company. As a rule, the company itself will cease to exist at the end of the bankruptcy proceedings and the shareholders of the company will no longer have a stake in the business (unless they purchase the business or assets from the receiver). It is not so much a reorganisation as a liquidation.

Judicial reorganisation is a procedure aimed at enabling a company in financial difficulty to restructure itself in order to continue its activities and pay back its creditors. Unlike bankruptcy, the aim is not the liquidation of the company, but its survival. During judicial administration, the debtor is protected against its creditors and cannot be declared bankrupt.

Voluntary liquidation is the result of a decision of the shareholders’ meeting to dissolve the company. It results in the liquidation of assets of the company and the company will cease to exist. In practice, a company is often “liquidated” as a matter of fact, by ceasing the activities and selling off the assets before the formal decision to dissolve is taken. The formal liquidation in such cases mainly involves drawing up the liquidation accounts and distributing the proceeds.

All three procedures can be used by companies with a commercial nature. This Guide will not deal with the procedures applicable to other companies or organisations, or to physical persons (individuals).

Bankruptcy

When is a Company in State of Bankruptcy?

Under Belgian law, a situation of bankruptcy arises when two conditions are simultaneously met:

- The relevant company has generally stopped paying its (financial and/or trade) debts as they fall due (is in staking van betaling/est en état de cessation de paiement); and
- The company has lost the confidence of its creditors (loss of creditworthiness: geschokt krediet/credit ébranlé). A company is deemed to have generally lost all creditworthiness when it can show that it cannot receive credit on the market (typically with financial institutions) at reasonable conditions for an amount that is sufficient to pay the company’s debts as they fall due. Generally, when the company’s customary credit providers have terminated all credit lines, a court will assume that other credit institutions, which are less familiar with the company’s business, will not extend credit either.

In other words, under Belgian law, bankruptcy is caused by a lack of liquidity, not by a lack of solvency. It is possible that a company is in state of bankruptcy even though its assets exceed its liabilities. It is also possible that the liabilities greatly exceed the assets without bankruptcy, e.g. where the liabilities are not due and payable, or if banks or other third parties are willing to give credit to the company.
When Can or Should the Company File for Bankruptcy?

A Belgian company that meets the two criteria set out under “When is a Company in State of Bankruptcy?” above is under a legal obligation to file for bankruptcy within one month from the time when these conditions are first met.

Failure to make the appropriate filings exposes the board of directors to both civil and criminal liability. A timely filing, on the other hand, does not necessarily shield directors against liability.

Who Should File for Bankruptcy?

Board of Directors

It is the sole authority of the board of directors of the company (or, in certain cases, its liquidator) to file for bankruptcy. The board of directors must take the decision to file for bankruptcy and can give a proxy to one of the directors or a third party to make the actual filing.

The shareholders’ meeting does not have to approve the decision to file for bankruptcy. As a matter of law, the shareholders’ meeting cannot instruct the board of directors or another agent to file for bankruptcy.

Third Parties

Even in the absence of a bankruptcy filing by the company, a court can declare a company bankrupt at the request of its creditors or the public prosecutor, or on the basis of information provided by the Commercial Investigations Division (which is a special branch of the Commercial Court charged with monitoring the financial performance of distressed entities) or by the company’s employees.

Employee Information

It is worth noting that, at the time of filing for bankruptcy (at the latest), a copy of the petition for bankruptcy and the data supporting the state of bankruptcy must be communicated to, and discussed with, the representatives of the company’s employees.

How to File for Bankruptcy

Where?

The petition for bankruptcy must be filed with the registrar of the Commercial Court that has jurisdiction over the registered office of the company at the time of the payment stoppage, and must be drafted in the official language of that court.

Documents to be Provided

As a bankruptcy procedure is not a reorganisation, it is not required (or even customary or useful) to include a plan of reorganisation with the file submitted to the court. As bankruptcy is essentially a liquidation procedure, the file that has to be submitted is a straightforward inventory of the assets and liabilities of the company. The file should allow the court to assess whether the company is in a state of bankruptcy and the receiver to immediately seize control of the company.

The Bankruptcy Act provides a list of items to be included in the file. Often the registrars of local courts supplement this list with their own informal lists, but, as a rule, a file is complete if the following items are included:
- A balance sheet of the company (or a memorandum explaining why it is impossible to provide this balance sheet);

- The account books of the company;

- Detailed information with respect to employees and social matters: the register of employees; the individual accounts of employees of the current and the preceding calendar year; information with respect to the social administration office and the social fund of the company; the identity of the members of the committee for prevention and protection at work and the members with trade union representation; and the access code provided by the Federal Social Security Service to the company (for the electronic register of employees);

- A list of the names and addresses of the customers and suppliers of the company; and

- A list with the names and addresses of any natural persons who gave a guarantee without consideration to the company.

The balance sheet includes an overview of all assets and liabilities in accordance with the accounting legislation; an overview and estimate of all tangible property (movables and real estate); an overview of all accounts receivable and accounts payable; an overview of the profit and losses; the last profit and loss account properly closed; and an overview of payments. All these documents have to be certified as being genuine and must be signed and dated by the company. In practice, this means that the board of directors should approve these documents and have them signed by directors authorized to represent the company.

The file is usually accompanied by a request setting out the reasons why the company is in state of bankruptcy. It is advised to add to the file any evidence to support this claim.

Adjudication of Bankruptcy and Appointment of a Receiver

Bankruptcy Judgment

The court will verify whether the petition for bankruptcy is formally valid and whether the conditions for bankruptcy are met. If both are confirmed, the court will declare the company bankrupt. The bankruptcy judgment has an immediate effect, as of “hour zero” of the day on which it is issued.

The bankruptcy judgment can be appealed by the company itself (in cases where a third party requested the bankruptcy). Interested third parties (such as directors, shareholders, or conceivably even creditors or employees) can oppose the bankruptcy judgment. An appeal or third-party opposition has no influence on the effects of the bankruptcy judgment until it is revoked.

The Receiver

As of “hour zero” of the day on which the bankruptcy is declared by the Commercial Court, a receiver in bankruptcy (curator/curateur) is appointed to assume all responsibilities from the board of directors and other corporate organs. The court has absolute discretion regarding the identity and the number of receivers appointed; however, the receiver has to be a licensed insolvency practitioner registered on the list of receivers held by the court. For bankruptcies of large companies, it is not unusual to appoint a committee of receivers. For bankruptcies of a certain size, courts are likely to appoint receivers with experience and/or expertise in the industry concerned.
The court will also appoint a judge-commissioner to supervise the receiver. The judge-commissioner is typically a lay judge: a person who is not a full-time magistrate or even a lawyer, who is often involved in business himself, and who assists the professional magistrates of the Commercial Court.

As of his appointment, the receiver will physically visit the premises of the company and seize control over all its assets, accounts, archives and information.

The receiver’s task is to compile an inventory of all debts of the company, even if not yet due, to sell off the (remaining) assets of the company and to pay the creditors, according to their legal or contractual priority rights.

As of “hour zero” of the day of bankruptcy, the company loses every power over its assets and liabilities. The receiver has full control over the company, only subject to the oversight of the court and the judge-commissioner. To seize control should be taken literally: the receiver will, as a rule, control the keys, access codes, bank accounts, etc. While the board of directors and the shareholders’ meeting formally remain in place, they no longer have any power or influence over the company. Again, this should be taken literally: unless with the permission of the receiver, directors will not be allowed to enter the premises of the company, use their company laptops or cell phones, or log in on the computer systems. Directors have a duty to cooperate with the receiver.

Further Procedure

The creditors must file a declaration of their claim on the company with the receiver. Any disputes regarding these claims will be decided by the Commercial Court.

The involvement of the creditors in the administration of the bankruptcy estate is limited.

At the end of the proceedings, the receiver uses the proceeds of the liquidation to pay the creditors in the order of their priority, and the bankruptcy proceedings will be closed. The company will then cease to exist.

Bankruptcy proceedings, especially in the case of important companies, can take several years, particularly if the receiver decides to continue the company’s activities or if he files civil or criminal suits against third parties, such as former directors or shareholders.

This Guide does not elaborate on matters involving a bankruptcy that are of a more procedural nature.

Consequences of Bankruptcy

As of the declaration of bankruptcy, individual creditors can no longer enforce their claims on the company’s assets. Attachments are automatically lifted and measures to enforce judgments are suspended. This prohibition to continue enforcing claims also applies to (most) secured creditors, who may be forced to wait one year before obtaining payment of their claim. All creditors must file an application to have their claims and receivables included amongst the claims of the bankruptcy estate.

In principle, the receiver will sell all assets of the company with a view to applying the proceeds of such sales towards payment of the creditors of the company.

As a rule, bankruptcy results in the cessation of all the company’s activities. At the request of the receiver or any interested party complying with certain conditions, the court may authorize the temporary continuation of (all or part of) the company’s activities under the supervision of the receiver. The court will grant that authorisation only if there is a
reasonable chance that the business can be sold as a going concern at a higher price than
the expected proceeds of the sale of the individual assets.

In principle, the bankruptcy does not trigger the termination of the contractual rights and
obligations of the bankrupt company that are still in force on the date of bankruptcy, unless
these contracts are contracts \textit{intuitu personae} (i.e. contracts in which the identity of the
performing party is a substantial element for the other party) or contracts with an explicit
cancellation clause. The receiver rules on the continuation of the contracts.

Costs of Bankruptcy

The court fees for the filing for bankruptcy are nominal. If bankruptcy is declared, these costs
become costs of the estate.

The main costs of bankruptcy are the fees of the receiver(s) (which are calculated partially
as a function of the work performed (hourly rates) and partially based on the proceeds that
the receiver can recover for the creditors) and any expenses incurred by the receiver on
behalf of the administration of the estate. This includes any liabilities resulting from the
continuation of the activities of the company.

Costs of the estate have priority over the other claims of other creditors.

Judicial Reorganisation

New Act on Continuity of Undertakings

On 20 January 2009, the Belgian Parliament approved the new Act on the Continuity of
Undertakings (the \textit{Continuity Act}), repealing the previous 1997 Act on Judicial
Administration and introducing a new reorganisation procedure. To address certain shortfalls
of the initial act, the Continuity Act was amended in 2013.

While the judicial administration was not widely used under the 1997 Act, it is the ambition of
the legislature that the new act replace bankruptcy as the “default” procedure for a company
threatened with, or in a situation of, insolvency.

Overview of Reorganisations under the Continuity Act

The Continuity Act offers companies four routes by which to maintain continuity:

- An amicable agreement (\textit{minnelijk akkoord}/accord amiable);
- A judicial reorganisation by way of amicable agreement (\textit{gerechtelijke reorganisatie
deroor een minnelijk akkoord}/judiciaire par accord amiable);
- A judicial reorganisation by way of collective agreement (\textit{gerechtelijke reorganisatie
deroor een collectief akkoord}/judiciaire par accord collectif); and
- A judicial reorganisation by way of transfer under judicial authority (\textit{gerechtelijke
reorganisatie door overdracht onder gerechtelijk gezag}/judiciaire par transfert sous
autorité de justice).

The first route of the amicable agreement is essentially the same as a private agreement
entered into by the company and all or some of its creditors in respect of its indebtedness.
As with a private agreement, it is not binding on creditors who are not party to the
agreement. The difference is that certain payments made pursuant to the amicable
agreement (which must be registered with the Commercial Court) enjoy protection against
challenges under certain provisions of the Bankruptcy Act on challengeable transactions in case of a subsequent bankruptcy.

The three alternative judicial routes are outlined under “Three Judicial Routes” below. They are jointly referred to as “judicial reorganisation”.

Conditions for Opening a Judicial Reorganisation

A request for judicial reorganisation can be made if there is a real threat that the company will cease to trade (threat of discontinuity of the business). This will be presumed in cases of capital impairment (when, as a result of losses, the net assets of the company are less than 50% of the share capital of the company).

The threat of ceasing to trade does not have to be immediate.

A judicial reorganisation can also be granted where a company is in a bankruptcy situation.

If the company has made a request for judicial reorganisation in the past three years, the only new request it can make is for a judicial reorganisation by way of transfer under judicial authority. Furthermore, if a judicial reorganisation was granted in the period between five and three years before the new request, any new reorganisation procedure may not prejudice the rights of creditors obtained during the initial procedure.

Where manifest and serious shortcomings of the board of directors or the shareholders’ meeting of the company endanger its ability to continue to trade, and where the appointment of a judicial administrator can safeguard the company’s ability to continue to trade, the Continuity Act allows any interested third party (such as creditors or employees) to request in a summary proceeding that the court appoint a judicial administrator.

When Should the Company File a Request for Judicial Reorganisation?

There is no obligation on the company to file a request for judicial reorganisation where the conditions for such proceedings apply.

In theory, directors can be held liable for the failure to file such a request if it can be demonstrated that the failure has caused damages to the company or its creditors. Cases imposing directors’ liability solely on this ground were rare under the previous regime of judicial administration; however, the increased flexibility offered under the new Continuity Act might, in practice, lead to a lower threshold for holding directors liable.

If the discontinuity of the activities is a real threat, it is advisable that the board of directors investigate the feasibility of a judicial reorganisation and make a motivated decision.

Who should File the Request for Judicial Reorganisation?

**Board of Directors**

The authority to file for judicial reorganisation lies with the board of directors of the company. The board of directors must take the decision and can give a proxy to one of the directors or a third party to file for judicial reorganisation.

It can be argued that the shareholders’ meeting does not have to approve the decision to file a request for judicial reorganisation. It is, however, advisable that they obtain, if feasible, shareholders’ approval prior to filing for judicial reorganisation.

As a matter of law, the shareholders’ meeting cannot instruct the board of directors or another agent to file a request for judicial reorganisation.
Public Prosecutor and other Third Parties

The public prosecutor and any other third party with a legitimate interest can start a judicial reorganisation by way of transfer under judicial authority by summoning the company before the Commercial Court.

How to File the Request for Judicial Reorganisation

Where?

The request for judicial administration must be filed with the registrar of the Commercial Court that has jurisdiction over the registered office of the company at the time of the request, and must be drafted in the official language of that court.

Documents to be Provided

The Continuity Act provides a list of items to be included in the request, failing which the request will be denied:

- A summary of the events giving rise to the request for judicial reorganisation, demonstrating that the continuity of the company is immediately or in the future under threat;
- An indication of the goal(s) the company wants to accomplish with the judicial reorganisation;
- The electronic address of the company (as referred to in the Belgian Judicial Code);
- The two most recent financial statements of the company (that should have been filed according to the articles of association and, if applicable, the financial statements relating to the last financial year that have not yet been filed);
- A balance sheet setting out the assets and liabilities of the company and an income statement not older than three months, drawn up under the supervision of an auditor, external accountant/bookkeeper or an external licensed bookkeeper or tax consultant;
- A simulation of cash flows for at least the requested duration of the suspension period, drawn up with the collaboration of an auditor, external accountant/bookkeeper or an external licensed bookkeeper or tax consultant;
- A complete list of the creditors of the company (including persons who allege to be creditors), with their names, addresses, claims and, if applicable, reference to any security or legal privilege;
- Any measures or proposals contemplated: to restore the profitability and solvency of the company; to implement a social plan, if any; and to pay off the creditors;
- An indication that the company has fulfilled its legal or contractual obligations to inform or consult the employees or their representatives; and
- Additionally, the company can also include any other documents it deems useful.

Until the court has issued a judgment granting or denying the request for judicial reorganisation, the company cannot be declared bankrupt or be forced to liquidate, and no forced sale of assets of the company will be allowed to continue. If a judicial administration is granted, this protection continues (see below).
If any of the information submitted to the court proves to be manifestly wrong or incomplete, the court can impose the early termination of the judicial reorganisation. Moreover, this is a general sanction the court can impose for any submission of information that is manifestly wrong or incomplete to the court, delegate judge (as described hereafter) or creditors during the proceedings.

Registration Fee

A request for judicial reorganisation is subject to payment of a registration fee of EUR 1,000.

Appointment of a Delegate Judge and Judgment Permitting the Judicial Reorganisation

Appointment of a Delegate Judge

Upon the filing of the request for judicial reorganisation, the court appoints a delegate judge (gedelegeerd rechter/juge délégué). The delegate judge is responsible for the correct application of the Continuity Act and has the duty to inform the court of any evolution or change in the financial condition of the company.

The delegate judge can hear the company and any other person he deems necessary and can request all information required to properly assess the situation of the creditors, setting out his findings in a report.

Reorganisation File - Request for Production of Additional Documents

Any creditors and, after permission by the delegate judge, any interested third party can consult the reorganisation file and request a copy.

The court and the delegate judge have extensive powers to order the company or any third party (including the shareholders) to produce documents which are relevant to a determination of whether the conditions for a judicial reorganisation or for any other measure in the Continuity Act are fulfilled.

Judgment Permitting Judicial Reorganisation

The court will hold a hearing on the request for judicial reorganisation within 14 days of the request being filed.

The company is summoned three days in advance of the hearing. The hearing takes place in chambers, unless the company requests otherwise.

The court must make its decision within eight days of the hearing.

If the court grants the judicial reorganisation, it must determine the duration of the suspension period, which cannot exceed six months. However, upon report by the delegate judge, the court can extend the suspension period by no more than 12 months from the date of the judgment granting the suspension. In extraordinary circumstances, the suspension period can be extended by an additional six months. An extension of the suspension period must be requested at the latest 14 days before its expiry. If a judicial reorganisation by collective agreement was requested, the court also sets the date for the voting on the reorganisation plan.

Upon the request of the company or any other third party with an interest, the court can appoint a judicial mandatee (gerechtsmandataris/mandataire de justice) to assist the company in its reorganisation. The courts have not yet, to our knowledge, established lists of
judicial mandatees, but it can be reasonably expected that the list will mainly consist of insolvency practitioners.

Upon the request of any third party or the public prosecutor, the court can also appoint one or more judicial mandatees for the term of the reorganisation if the company (or any of its bodies) commits a manifestly serious shortcoming.

If the company (or any of its bodies) commits a manifestly serious wrongdoing or has shown signs of bad faith, the court can, upon the request of any third party or the public prosecutor, appoint a provisional administrator for the term of the reorganisation. The provisional administrator replaces the existing bodies of the company.

Effects if Reorganisation is Granted

Bankruptcy Protection

Once judicial reorganisation is granted (and until it would be revoked), the company cannot be declared bankrupt or be forced to liquidate.

The mere fact that the company would otherwise be in a situation of bankruptcy is not in itself a reason to terminate the judicial reorganisation.

Any procedure in judicial reorganisation can be terminated before the end of the suspension period at the request of the company or by order of the court. The company can request the procedure to be terminated. The court issues a judgment after having heard the delegate judge and can decide to end the procedure in judicial reorganisation completely or partially.

The commercial court can also order the termination of the procedure in judicial reorganisation if the company is clearly unable to guarantee its continuity any further. The court can subsequently declare the company bankrupt or order the company’s forced liquidation in the same judgment.

Suspension of Enforcement Rights

During the suspension period, the enforcement rights of creditors whose claims originated before the reorganisation period are suspended:

- New attachments and seizures are impossible during the suspension period;
- Attachments that were made prior to the suspension period remain in place, but the court can release these attachments upon recommendation by the delegate judge provided the release does not cause a significant harm to the relevant creditor.

The suspension period does not have any impact on the rights of privileged creditors, but they will not be able to enforce their rights during the suspension period (other than as provided for under the Act of 15 December 2004 on financial collateral, i.e. that security interests on financial instruments and on cash can be enforced at any time. However, according to the aforementioned act, pledges of cash or bank receivables are no longer enforceable during a judicial reorganisation).

The suspension period does not have any impact on receivables that were pledged specifically: those can be enforced during the suspension period, without prejudice to the court’s competence to suspend such enforcement.

As a general rule, set-off between claims that originated before the start of the judicial reorganisation and those that originated after the start is not possible unless these claims are intimately linked.
The suspension does not affect any receivables pledged to a third party, save for the enforcement of pledges of cash and bank receivables.

As a rule, the suspension has no effect on co-debtors, guarantors or sureties.

**Protection of Payments against Challengeable Preferences**

The suspension period does not prevent voluntary payments by the company, provided that there is a connection between the payment and the preservation of the continuity of the company.

Any payments made during the judicial reorganisation cannot be challenged under articles 17, 2° and 18 of the Bankruptcy Act in the case of a subsequent bankruptcy. These provisions allow the challenge of any payments of debts that were not yet due, any payments in kind even for due debts, and any payments made to third parties who were aware that the company had generally ceased to pay its debts. Many questions regarding the interpretation of these provisions remain. While payments made during the reorganisation cannot be challenged under articles 17, 2° and 18 of the Bankruptcy Act, it would appear that they can still be challenged under article 1167 of the Civil Code, which imposes a higher threshold for annulment (i.e. proof that the debtor made the payment with the fraudulent intent to prejudice the rights of other creditors).

**Effect on Existing Contracts**

Judicial reorganisation does not terminate existing contracts, nor does it change the terms of their execution, regardless of any provisions in such contracts to the contrary. A default under an existing contract of the company prior to obtaining judicial reorganisation cannot be used to terminate such a contract, unless the company does not remedy the default within 15 days after being formally notified thereof.

The company can opt not to continue a contract for the duration of the suspension period if the non-continuation is necessary for the reorganisation plan or the transfer under judicial authority. Any damages as a result of such termination have the same status as claims which originated prior to the judicial reorganisation. This option does not, however, apply to labour contracts.

Penal clauses or clauses providing lump sum damages (including increases in the applicable interest rate) are unenforceable during the judicial reorganisation until the reorganisation plan has been fully executed vis-à-vis the creditors affected by the plan. If a creditor claims actual damages, he is deemed to have forfeited his rights under a penal clause providing lump sum damages (even after the execution of the reorganisation plan).

Any claims under existing contracts which continue to be performed during the reorganisation (including claims for conventional interest) are not subject to the suspension of creditors’ rights, provided those claims relate to the period following the start of the judicial reorganisation.

**Subsequent Bankruptcy or Liquidation**

Contractual claims can become “costs and expenses of the estate” in a subsequent bankruptcy or liquidation, provided that:

- They relate to the period following the start of the judicial reorganisation; and
- There is a close link between the bankruptcy or liquidation and the end of the judicial reorganisation.
It remains unclear whether claims other than contractual claims can become costs and expenses of the estate.

Three Judicial Routes

In principle, the company must choose one of the three available judicial routes in its request for judicial reorganisation. However, during the suspension period, the company is able to request that the court change the procedure either: from a judicial reorganisation by way of amicable agreement into a judicial reorganisation by way of collective agreement or by way of transfer under judicial authority; or from a judicial reorganisation by way of collective agreement into a judicial reorganisation by way of transfer under judicial authority. Recently, following a partial transfer of its estate via judicial reorganisation by way of transfer under judicial authority, the company is also allowed to suggest a reorganisation plan for the balance of its estate.

Judicial Reorganisation by Way of Amicable Agreement

This procedure is similar to the amicable agreement described. The company can enter into an agreement with all, or two or more, of its creditors in respect of its indebtedness. Articles 17, 2° and 18 of the Bankruptcy Act will not apply in a subsequent bankruptcy (see the above paragraph on “Protection of Payments against Challengeable Preferences”).

This differs from a normal amicable agreement as there is supervision and assistance from a delegate judge and a judicial mandatee. The agreement is also not registered with the court, but accepted by the court and published in the Belgian Official Gazette.

Judicial Reorganisation by Way of Collective Agreement

Under this procedure, the company presents a reorganisation plan to its creditors, who then vote on the plan.

The plan needs to contain a proposition to reorganize the company. The plan must have a descriptive section which sets out the difficulties of the company, and a section that provides for possible solutions.

The plan can provide for instalment periods, debt reduction and transfer of debt into equity. The plan can also provide for the transfer of all or part of the business of the company and for the suspension of the enforcement rights of privileged creditors for a duration of 24 months (which can be extended for an additional 12 months).

The duration of the plan cannot exceed five years. The judicial mandatee (if appointed) assists in drafting the reorganisation plan.

The company must provide a list of its creditors to the court, which will verify the list and, upon the report of the delegate judge, determine who the creditors of the company are and the amount of their claims (the “creditors in suspension”). During the suspension period, the court can, at the request of the company or one of its creditors, decide to alter the list of creditors in suspension or the amounts of their claims.

The creditors in suspension vote on the reorganisation plan. The plan is approved if at least half of the creditors in suspension representing at least half of the total indebtedness of the company agree to the reorganisation plan. The holders of special privileges or security interests (such as pledgees or mortgagees) need to give their individual consent if their rights are affected by the plan. Some claims cannot be waived in the reorganisation plan. These include criminal fines and claims relating to labour performed before the opening of the proceedings.
The plan is then approved by the court. The court can refuse to approve the plan only if the provisions of the Continuity Act were not respected or if the plan violates public policy. The court can also allow the company to submit an adjusted reorganisation plan to the creditors. The decision of the court is published in the Belgian Official Gazette.

Disputed claims that are judicially recognised after the approval of the plan by the court will be treated in the same manner as similar claims of creditors in suspension.

If the company complies with the provisions of the plan, it will be released from all claims of the creditors in suspension. Any creditor of the company can request the cancellation or annulment of the plan if the company does not comply with its provisions.

**Judicial Reorganisation by Way of Transfer under Judicial Authority**

The transfer of all or part of the business can be ordered by the court upon request of the company.

The court can also order the same upon request of the public prosecutor if:

- The company is in a state of bankruptcy without having filed for judicial reorganisation;
- There is an early termination of the procedure in judicial reorganisation;
- The creditors do not approve the reorganisation plan; or
- The court refuses the approval of the reorganisation plan.

If the company requests a transfer, the employee representatives of the company must be consulted.

A transfer will be without effect on the labour contracts in existence (they will transfer with all or the part of the business that is transferred) unless the employee representatives agree otherwise.

The transferee decides which employees are transferred as part of the transfer under judicial authority. His decision must be based on technical, economical and organisational grounds.

The transferee, the transferor or the judicial mandatee can request the Court of Labour to confirm (“homologate”) the transfer.

The judgment ordering the transfer also appoints a judicial mandatee who is responsible for realising the transfer. He organizes the transfer and must strive to keep all or part of the activities together, whilst taking into account the rights of the creditors. The judicial mandatee can request concrete evidence on employment matters and the payment of the purchase price as well as financial and business plans or projects. He will draft one or more sales agreements to present to the delegate judge and the court. The court must authorise the judicial mandatee to continue the sale or sales.

If a draft sales agreement proposes a number of different buyers or different terms, the court must decide between them. In the event of similar offerings, the judicial mandatee (and not the court) will give preference to the offer that guarantees the maintenance of employment through a social agreement.

If a person that supervises (i.e. exercises control over) the company or has supervised the company, and via another legal person simultaneously has control over rights that are
necessary to preserve the continuity of the activities of the company, offers to purchase the company’s estate, that offer can only be taken into account conditionally upon the rights being accessible to the other bidders. It is not clear whether change of control clauses are affected by this measure.

The purchase price for the estate may not be lower than its presumed value if the business will be discontinued.

If real estate is to be sold, the company or its creditors with a privileged right on the real estate can request that the court impose certain conditions on the sale of that real estate, such as a minimum price.

If the judicial mandatee believes the transfer has been finalised, he requests the court to declare the judicial reorganisation closed and to relieve him of his duties.

Voluntary Liquidation

Conditions for Liquidation

The shareholders’ meeting of a company can decide at any time to voluntarily dissolve the company. After a liquidation, the company will cease to exist.

No specific conditions as to the state of the company apply for a voluntary liquidation. In theory, it is conceivable that an interested third party will ask for the nullification of a decision to dissolve and liquidate, on the grounds that it is not in the corporate interest.

Case law allows the voluntary liquidation of a company, even if it appears that the liabilities will exceed the assets. Furthermore, the courts apply the conditions for bankruptcy differently in the case of a company which is in voluntary liquidation: as long as the creditors generally remain confident that the liquidator is prudently and honestly performing its duties, the courts may not declare the company bankrupt, even when it has stopped making payments.

In certain circumstances, third parties can apply to the court for the forced dissolution and liquidation of the company.

Liquidation Procedure

Preparation of Reports

The board of directors prepares a special report in which it justifies its proposal to dissolve the company. The board of directors must attach to its report a balance sheet of the company that is less than three months old at the date of the shareholders’ meeting referred to below. This balance sheet must be established in accordance with generally accepted accounting principles in Belgium (“Belgian GAAP”) taking into account that the company will be liquidated (and will no longer operate as a going concern).

The statutory auditor of the company must review the aforementioned balance sheet and indicate in a special report whether the balance sheet gives a complete, true and fair view of the company’s financial situation.

Extraordinary Shareholders’ Meeting

Subsequently, the board of directors convenes, at a time and date decided at the discretion of the board, an extraordinary general shareholders’ meeting of the company which is to be held before a Belgian Notary Public. At this meeting, the shareholders will consider a resolution to dissolve the company (i.e. put it into liquidation) and appoint the liquidator(s).
Confirmation by the Court of the Appointment of the Liquidator(s)

The appointment of the liquidator(s) must be confirmed by the court of the district where the company has its registered office on the date of the dissolution.

For this purpose, a unilateral request must be filed with the Commercial Court. The practice of the courts depends on the district, but generally this request must include:

- A balance sheet of the company (the same balance sheet as attached to the special board report referred to above can be used), to be signed by the liquidator;
- A copy (certified by the Notary) of the notarial deed recording the minutes of the shareholders’ meeting referred to above;
- A certificate of the good behaviour of the liquidator (i.e. the Belgian bewijs van goed gedrag en zeden or a similar document under the laws of the nationality of the liquidator(s)); and
- A declaration on honour by the liquidator that he has never been declared bankrupt.

The court will confirm the appointment only after verifying the integrity of the liquidator(s). If the court refuses to confirm the appointment of the liquidator(s), it will appoint another liquidator, possibly upon proposal of the general shareholders’ meeting.

The liquidator can take actions between his appointment by the shareholders’ meeting and the confirmation of his appointment by the court, but such actions subsequently need to be confirmed by the court. The court can refuse such confirmation and declare all or some of these actions null and void if it finds that they constitute a manifest breach of the rights of third parties.

In practice, the court’s judgment is normally passed within a period of two to three business days following the submission of the unilateral request.

Filing and Publication

The notarial deed recording the shareholders’ resolutions to dissolve the company and to appoint the liquidator(s) must be filed as soon as possible with the office of the clerk of the court. This can be validly done only if a copy of the court’s decision to confirm the appointment of the liquidator(s) is attached to such notarial deed.

An excerpt from the notarial deed will subsequently be published in the annexes to the Belgian Official Gazette.

Liquidation Process

During the liquidation process, the liquidator(s) must sell the assets and pay the debts of the company. Any net liquidation proceeds are paid to the shareholders of the company.

To the extent that the liquidation is not yet closed at that time, the liquidator must submit, in the sixth and twelfth month of the first year of the liquidation process, a detailed statement of the company’s liquidation status to the office of the clerk of the Commercial Court. This statement must include the income and expenses, the distribution to creditors, an overview of the outstanding debt, etc. As of the second year of the liquidation process, this statement must be submitted only once a year.
Closing of the Liquidation

Once the aforementioned liquidation process is completed, the liquidation can be closed. As long as the liquidation is not formally closed, the dissolved company will legally continue to exist as a legal entity. The liquidation is normally closed when all liabilities and legal claims against the company are settled.

When the liquidator(s) have completed the liquidation process, they must prepare liquidation accounts, which must be audited.

The liquidator(s) must also prepare a plan for the distribution of the assets to the different creditors and submit this plan to the court for approval. Although no specific formalities are prescribed by law, the submission is normally made by means of a unilateral request. The court can request the liquidator(s) to provide additional information in order to verify the validity of the plan. The liquidation can be closed only when the court’s approval of the plan has been obtained.

Shareholders' Meeting/Resolutions

Subsequently, the liquidation accounts and the underlying justification documents must be submitted to a shareholders’ meeting. This meeting does not need to be held before a notary public (and can be organized by means of unanimous and written resolutions), unless the assets to be distributed would include real estate.

At least one month prior to the meeting, the liquidator(s) must deposit the liquidation accounts and justification documents at the registered office of the company. (In practice, most legal doctrine agrees that this period of one month can be waived by the shareholders, provided that all shareholders agree to such waiver.)

Post-Closing

For a period of five years following the closing of the liquidation, the liquidator(s) may still be held liable by third parties for mismanagement.

The shareholders’ resolution to formally close the liquidation must be published in the annexes to the Belgian Official Gazette.

Effects of a Decision of Dissolution and Liquidation

The decision to dissolve the company does not itself end the corporate existence of the company or the continuity of its activities.

As a rule, the rights of the creditors and the agreements in place remain unaffected by the dissolution. In case of an insolvent voluntary liquidation, the dissolution can, however, have effects similar to that of a bankruptcy. In particular, the creditors’ execution rights will be suspended and the liquidator can only take any actions to the extent that they respect the priorities between the creditors and the equality between the unsecured creditors.

Costs of a Voluntary Liquidation

Small fees must be paid in order to have the unilateral request recorded and make the required publication.

The costs of the notary should normally be less than EUR 1,500. The main costs are those arising from the sale of the assets, including the fees of the liquidator(s), who will normally be paid on an hourly basis.
Dissolution and Liquidation on Same Day

It is possible to voluntarily dissolve and liquidate a company on one and the same day, provided that certain conditions are met, specifically the absence of outstanding debts and a unanimous resolution of the shareholders’ meeting, and without prejudice to certain reporting requirements.

Summary Overview of Priorities between Creditors

Costs and Expenses of the Procedures

In the case of bankruptcy, the proceeds of the sale of the assets of the bankrupt estate are first used to pay the costs and expenses related to the management of the bankruptcy estate. Costs of the estate include any liabilities incurred by the bankruptcy trustee in the continuance of the activities of the company.

In the case of the voluntary dissolution of an insolvent company, the same rule applies to the costs and expenses incurred by the liquidator.

No similar rules apply in case of a judicial administration, but costs made with the authorisation of the court commissioner during the period of payment suspension can receive the same priority as the costs of the bankruptcy estate in cases where the judicial administration ends in bankruptcy.

Priorities

Creditors with a security interest (such as a mortgage or a pledge) or privileged creditors are paid before unsecured creditors.

Privileged creditors may benefit from a “general” or a “special” privilege:

- A general privilege entitles the holder to a certain priority at the distribution of the proceeds of all assets. A general privilege holder cannot interfere with the liquidation procedure and will enjoy priority at the moment of the distribution of proceeds, if any;

- A special privilege is always related to one or more specific assets of the bankrupt estate. The holder of a special privilege is entitled to a prioritized payment out of the proceeds of the specific asset and can, in a number of cases, evade the suspension of creditors’ enforcement rights in cases of bankruptcy or a similar situation.

Examples of special privileges are, among others: the privilege of the unpaid lessor; the privilege of the unpaid seller; the privilege of the subcontractor; and the privilege of the Work Accident Reserve Fund.

Examples of general privileges on all movable assets are, mainly, the “social” privileges and the privileges of the tax authorities. The social privileges include, among other things: the net wages of employees; the claims of the Company Closure Fund (severance pay); claims for holiday contributions and bonuses; claims of work accident victims; the privilege of the social security authority; and the privilege of the Occupational Diseases Fund. The privileges of the tax authorities deal with both direct and indirect taxes.

There has been a proliferation of privileges and the ranking order of priorities is a complicated area of law, of which this Guide can only give a flavour.
By way of general rules:

- Creditors with a security interest or a special privilege are paid before the costs and expenses of the bankruptcy estate, unless they benefited from those costs and expenses;
- Creditors with a security interest and special privilege holders prevail over a general privilege holder;
- A conflict between a creditor with a security interest and a special privilege holder on the same asset will generally be decided by the date on which the security interest or privilege originated or was perfected; and
- General privilege holders prevail over unsecured creditors.

Proportional Distribution

If any assets remain, the proceeds are distributed proportionally amongst the unsecured creditors.

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Overview and Introduction

This summary describes the most relevant aspects of the Insolvency Procedures regulations in Brazil. It sets out:

- A description of the Insolvency Procedures;
- The conditions and requirements for triggering such regimes;
- The legitimate parties who are able to initiate the procedure (i.e. debtor, creditors, third parties);
- The creditors notified of the commencement of the Insolvency Procedures;
- The main consequences arising from the commencement of the Insolvency Procedures;
- Possible deprivations imposed on a debtor regarding the management of its business;
- Mandatory stay;
- Set-offs;
- Suspicion period or preference period;
- Order of priorities and privileges in the collection of the debtor’s obligations;
- Rights of secured creditors in each of the Insolvency Procedures;
- Rights of unsecured creditors in each of the Insolvency Procedures; and
- Approximate length of the Insolvency Procedures.

In Brazil, there are two legal regimes that regulate Insolvency Procedures: the Non-Financial Institutions Insolvency Procedures and the Financial Institutions Insolvency Procedures.

A summary of the main regulations set forth under the Insolvency Procedures is given below.

Non-Financial Institutions Insolvency Procedures

Brazilian Law No. 11.101, of 9 February 2005 (the “Bankruptcy Law”) regulates the Non-Financial Institutions Insolvency Procedures, namely:

- Extrajudicial restructuring;
- Judicial reorganisation; and
- Bankruptcy.

We summarize these procedures below.
Extrajudicial Restructuring

**Purpose of Extrajudicial Restructuring**

The purpose of the extrajudicial restructuring is to provide an alternative to the debt restructuring proceeding and to avoid the discontinuation of any productive business. The individual or legal entity that is in financial distress and will be unable to pay its debts upon maturity (the “financially distressed party”) may contact its creditors (or all creditors of a determined class) to present and discuss an extrajudicial restructuring plan aimed at obtaining more favourable terms and conditions for the payment of its debts (the “restructuring plan”). No specific means for this contact is set forth by law; in principle, all valid means of communication may be accepted. Negotiations with creditors should not be deemed evidence of the insolvency of the company, nor serve as a ground for a bankruptcy request.

**Conditions and Requirements for the Extrajudicial Restructuring**

An extrajudicial restructuring process may be commenced by any financially distressed party that has been regularly performing its activities for more than two years and complies with the following requirements:

- The applicant is not bankrupt;
- The applicant has not filed for judicial reorganisation during the previous five years; and
- The applicant, its controlling shareholders and its managers have not been convicted of any bankruptcy crime.

Additionally, the financially distressed party must not:

- Anticipate payment of any undue debt;
- Benefit certain creditor(s) in detriment of other(s), i.e. all creditors must receive equal treatment;
- Encompass in the restructuring plan any claim that was not existent at the time of the extrajudicial restructuring;
- Sell or replace any asset given in guarantee without the express consent of the guaranteed party; or
- Exclude the impact of the foreign variation to any debt denominated in a foreign currency without the express consent of the creditor.

**Parties that May Initiate the Extrajudicial Restructuring**

- The financially distressed party;
- Its heirs or the surviving widow/widower; or
- Its quotaholders or shareholders, as the case may be, pursuant to the relevant company's constitutional documents.
Main Consequences Arising from Extrajudicial Restructuring

Management of the Financially Distressed Party’s Business

Management continues as is, unless otherwise agreed in the restructuring plan.

Mandatory Stay

The ratification of the plan by the court will not interrupt any judicial proceedings pending against the financially distressed party, nor prevent other classes of creditors that are not encompassed by the restructuring plan from requesting its bankruptcy (in the event that the plan was not approved by three-fifths of each class of creditors).

Set-Off during the Extrajudicial Restructuring

The netting and setting-off of debts and credits are allowed under extrajudicial restructuring as long as the debts that are being set-off are not subject to the reorganisation.

Clawback Period

Not applicable.

Priorities and Privileges in the Payment of the Debtor’s Obligations

The financially distressed party may ask the relevant court to ratify the restructuring plan. Except for tax and labour claims, all other claims may be subject to a restructuring plan.

Upon the court’s ratification, the restructuring plan will be enforceable against:

- All creditors (including those that have not agreed to the plan) if: (i) approved by at least three-fifths of each class of creditors (i.e. secured creditors and unsecured creditors) and (ii) the plan is ratified by the state court; or
- Only those creditors that have agreed to the plan, if approved by less than three-fifths of each class of creditors.

In addition to the tax and labour claims that are not subject to the restructuring plan, there are other classes of creditors against which the plan will be enforceable, even if they fail to agree to it. They are:

- Fiduciary owner;
- Mercantile lessor (*arrendador mercantil*);
- Real estate seller, with an irrevocable real estate purchase and sale agreement;
- Any seller that retains title to the asset until final payment is made; and
- Financial institutions that are creditors of anticipation for export transactions.

Approximate Length and Termination of the Extrajudicial Restructuring

Termination of Obligations

This is determined by the restructuring plan.
Length

This is determined by the restructuring plan.

Judicial Reorganisation

Purpose of the Judicial Reorganisation

The purpose of the judicial reorganisation is to provide viable means to the financially distressed party to overcome a financial and economic crisis so that the productive business, the maintenance of jobs and the interests of creditors are preserved, and, as a consequence, the company, its social function and the fostering of economic activity are also preserved.

Conditions and Requirements for Triggering the Judicial Reorganisation

A judicial reorganisation process may be commenced by any financially distressed party that has been regularly performing its activities for more than two years and that complies with the following requirements:

- The applicant is not subject to a bankruptcy procedure;
- The applicant has not filed for judicial reorganisation during the previous five years; and
- The applicant, its controlling shareholders and its managers have not been convicted of any bankruptcy crime.

Parties that May Initiate the Judicial Reorganisation

- The financially distressed party;
- Its heirs or the surviving widow/widower; or
- Its quotaholders or shareholders, as the case may be, pursuant to the relevant company's constitutional documents.

Main Consequences Arising from the Judicial Reorganisation

Management of the Financially Distressed Party’s Business

During the judicial reorganisation, the debtor may continue the administration of the business under the supervision of the creditors’ committee (if one is appointed by the general creditors’ meeting) and with the assistance of the judicial administrator (an individual appointed by the judge).

If the debtor is not allowed to: (i) manage the business and/or (ii) continue management of the business, a new administrator will be appointed based on the provisions of the corporate documents and/or on the reorganisation plan and/or on the decision issued by the general creditors’ meeting.

Mandatory Stay

The judicial reorganisation automatically suspends, for a period of 180 days, the statute of limitation periods of potential claims and collections by creditors of the financially distressed party (except for tax claims).
Set-Off during the Judicial Reorganisation

The netting and setting-off of debts and credits are allowed under the judicial reorganisation as long as the debts that are being set-off are not subject to the reorganisation.

Clawback Period

Not applicable.

Priorities and Privileges in the Payment of the Debtor’s Obligations

The rights and duties of the financially distressed party will be basically determined by a reorganisation plan, which is proposed by the debtor and accepted by the judge and by the creditors in a general creditors’ meeting.

The general creditors’ meeting is divided into four classes of creditors:

- Labour creditors;
- Secured creditors;
- Unsecured creditors; and
- Credits related to small companies.

The reorganisation plan will be approved only if accepted, in each class of creditors, by the majority of all of the creditors present at the general creditors’ meeting; and creditors representing more than 50% of the amount of the claims (except for labour creditors, for which only the first quorum will apply).

Rights of Secured and Unsecured Creditors

See “Priorities and Privileges in the Payment of the Debtor’s Obligation” above.

Approximate Length and Termination of the Judicial Reorganisation

Although the judicial reorganisation proceeding may last for a maximum period of two years, the Bankruptcy Law defines no specific term or form for implementation and duration of the reorganisation plan, which allows the financially distressed party to propose a feasible plan in light of its specific circumstances. The only exception is the term for payment of labour claims, which may not exceed one year.

If the reorganisation plan is not complied with, the creditors may file for bankruptcy of the financially distressed party.

Bankruptcy

Purpose of the Bankruptcy

The purpose of the bankruptcy is to liquidate the assets of the bankrupt party and use the proceeds to pay the creditors according to their respective priorities, whilst preserving and optimizing the productive use of its assets and resources to the extent possible. The bankruptcy also aims to sell productive units to preserve the business, to the extent feasible.
Conditions and Requirements for Triggering the Bankruptcy

The filing of a bankruptcy of an individual or entity is possible when it:

- Does not pay, on the maturity date, a debt higher than the amount equivalent to 40 minimum wages (currently equivalent to BRL 35,200);
- Does not indicate any assets to guarantee the judicial collection of a certain and undisputable debt;
- Commits fraudulent acts against its creditors;
- Commences selling relevant parts of its assets without the creditors’ consent;
- Abandons the business without leaving a representative to manage it;
- Does not comply, by the due date, with any obligation under the reorganisation plan agreed under the judicial reorganisation procedure.

Parties that May Initiate the Bankruptcy

Bankruptcy may be filed by:

- The insolvent individual or entity;
- His or her heirs;
- Its shareholders; or
- Any unpaid creditor of the insolvent individual or entity, as well as third parties.

Main Consequences Arising from the Bankruptcy

Management of the Bankrupt Party’s Business

The bankrupt party loses the ability to manage the company and the judge assigns the judicial administrator in its place. The bankrupt party loses the right to do business in Brazil until all of its obligations are settled.

Mandatory Stay

The judicial decision that declares the bankruptcy also:

- Stays all claims and/or collection lawsuits (except for labour claims and any lawsuit concerning debts that are not certain and liquid) in course against the bankrupt party;
- Prohibits the sale or encumbrance of any assets of the bankrupt party;
- Converts all claims in foreign currency into local currency;
- Cancels the right of the shareholders to withdraw from the bankrupt party (in case it is a legal entity);
- May order (if needed) the preventive detention of the bankrupt party and/or its managers;
- May order that the bankrupt party’s premises are sealed;
• May install a creditors’ committee to follow up the proceeding; and
• Shall fix the clawback period for the bankruptcy (which may not exceed 90 days).

Set-Off During the Bankruptcy

The Brazilian Bankruptcy Law provides that the debts of the financially distressed party that are due until the day of the bankruptcy’s declaration shall be set off, provided that any such set-off is allowed by civil law. Setting-off is not allowed with:

• Any claim transferred to the financially distressed party’s creditors after the bankruptcy declaration, except in the event of the succession, merger, amalgamation and spin-off of a company, or death; or

• Any claim transferred to the financially distressed party’s creditors when the status of economic and financial crisis of the financially distressed party was known, even if such claims were due prior to the bankruptcy declaration; or

• Any claim transferred in a fraudulent manner.

Clawback Period

The clawback period has the specific purpose of putting under suspicion any act of the bankrupt entrepreneur or company that could have been made with the purpose of depleting their assets in detriment of creditors. It may be fixed by the judge as 90 days from one of the following events:

• The date of the filing of the bankruptcy request;

• The date of any prior request for judicial reorganisation; or

• The date when the default of payment of a negotiable instrument issued by the bankrupt party is registered by the relevant Notary Public of Notes and Deeds (this is a public extrajudicial procedure known as “protest” or “protest of a negotiable instrument”, where “negotiable instrument” means a document - from a list of documents set forth by law - that entitles its holder to commence a judicial execution against the debtor, such as a promissory note).

Priorities and Privileges in the Payment of the Debtor’s Obligations

The proceeds of the liquidation of the bankrupt party’s assets must be paid to the creditors in the following order of preference:

(i) Super-privileges (credit that is not subjected to the bankruptcy, as defined by law);

(ii) Claims concerning labour rights and payments to labour severance funds take preference over any other claims in the bankruptcy proceeding, limited to an amount equivalent to 150 minimum wages per employee (currently equivalent to BRL 132,000). Any amount in excess to the equivalent of 150 minimum wages is treated as the unsecured claim of the employee;

(iii) Secured creditors (i.e. those creditors secured by one or more in rem guarantees), up to the amount of the guarantee, regardless of the nature and of the secured obligations and the time they were incurred. If the credit exceeds the amount of the guarantee, the amount in excess is treated as an unsecured claim;
(iv) Tax debts;
(v) Creditors with special privilege (as defined by law);
(vi) Creditors with general privilege (as defined by law);
(vii) Unsecured creditors (créditos quirografários); and
(viii) Subordinated creditors.

In view of the order of preference for payment of claims, the bankrupt party may not proceed with the netting and/or setting-off of debts and credits in violation of such priority order, under the penalty of such netting/set-off being regarded as null and void.

**Rights of Secured and Unsecured Creditors**

Creditors are officially notified by means of the publication of the judicial decision that declares the bankruptcy of the entity and the list of all creditors in the official newspaper. The judge, in this judicial decision, will also appoint a judicial administrator, who, after reviewing the company’s accounting books and other commercial and fiscal documents, shall prepare a list of creditors of the bankrupt individual or entity that have claims against it. Creditors may challenge the debts listed by the judicial administrator or request that their claims are included, if missing.

**Approximate Length and Termination of the Bankruptcy**

**Termination of Obligations**

The obligations of the bankrupt party to the creditors, employees and other interested parties will be terminated upon the earliest of the following events:

- The payment of all outstanding debts;
- The payment of more than 50% of the unsecured creditors, after the sale of all of the bankrupt party's assets;
- The elapse of five years counted from the end of the bankruptcy proceeding, provided that the bankrupt party or its managers have not been convicted for a bankruptcy crime; or
- The elapse of 10 years counted from the end of the bankruptcy proceeding, in case the debtor or its managers were convicted for a bankruptcy crime.

Until such obligations are terminated, the bankrupt party will be prevented from doing business in Brazil.

**Length**

The timeframe for a bankruptcy proceeding depends on the size of the bankrupt party and the complexity of its transactions. Although the Bankruptcy Law has been in effect for more than a decade, there are very few precedents in place to predict the timeframe for a proceeding. Under the pre-Bankruptcy Law regulations, the proceedings would take a long time to terminate (10, 20 or even 30 years). The current Bankruptcy Law envisions a faster procedure, but we estimate that, where the operations of the bankrupt party are complex and where it has many and active creditors, the proceedings will still take a long time.
Financial Institutions Insolvency Procedures

The procedures summarized below are applicable to financial institutions in Brazil.

General

Financial Institutions Insolvency Procedures are governed by Law No. 6,024/74 and have the following main features:

- They are determined by the Central Bank of Brazil (Banco Central do Brasil or “BCB”) and are subject to the discretion and intervention of that monetary authority;
- In case of a distressed situation of the financial institution, the BCB appoints an independent individual (often a regulator or a former regulator) to manage the insolvent financial institution’s business;
- The BCB may impose these procedures on other entities that have “integrated activities” or “common interest” with the distressed financial institution;
- “Integrated activities” or “common interest” occur when the entities are debtors of the financial institution under intervention or extrajudicial liquidation; or when their partners or shareholders participate in its capital with more than 10%; or when they are spouses or relatives up to the second degree, related by blood, with the managers or with the members of the consultative, administrative or audit committee members.

Intervention

Purpose of Intervention

Intervention aims to normalize the possible poor management and financial crisis of a financial institution.

Conditions and Requirements for Triggering Intervention

The BCB may declare intervention in a financial institution if it verifies the following abnormalities in the businesses of the institution:

- The institution suffers losses derived from bad management that subjects its creditors to risks;
- The BCB verifies repeated infractions of the banking laws that are not corrected after determinations made by the BCB;
- There are certain other situations defined in the Bankruptcy Law, but there is the possibility to avoid the extrajudicial liquidation.

Parties that May Initiate Intervention

The BCB, or the directors of the financial institution if its by-laws grant the directors powers to do so.

Main Consequences Arising from Intervention

Management of the Business

The BCB appoints an individual to act as interventor for the financial institution, with full powers of management.
**Mandatory Stay**

None.

**Set-Off During the Intervention**

Not applicable because business should continue as usual.

**Clawback Period**

Not applicable.

**Proceedings**

Within 60 days of the decree of the intervention, the interventor will prepare a report to the BCB, which will, based on said report:

(a) Determine the termination of the intervention;

(b) Keep the financial institution under intervention until the irregularities have been eliminated;

(c) Decree the extrajudicial liquidation of the entity; or

(d) Authorize the interventor to file for the bankruptcy of the entity, when:

   (i) The entity's assets are not sufficient to pay at least half of the unsecured claims;

   (ii) The extrajudicial liquidation is deemed beneficial; or

   (iii) The complexity of the businesses of the financial institution or the seriousness of the facts verified (under the liquidation) recommends such action.

**Approximate Length and Termination of the Intervention**

The term of the intervention shall not exceed six months, which may be extended for a further six months by the BCB.

The intervention will cease:

- If the interested parties present to the BCB appropriate guarantee conditions and assure the subsequent economic activities of the entity;

- When, according to the BCB, the situation of the business has been normalized; or

- If the BCB or the judge, as the case may be, decrees the extrajudicial liquidation or bankruptcy, respectively.

**Extrajudicial Liquidation**

**Purpose of Extrajudicial Liquidation**

The purpose of the extrajudicial liquidation is to liquidate the assets of the distressed financial institution and pay depositors and creditors pursuant to their priority rights.
Parties that May Initiate the Extrajudicial Liquidation

The BCB, upon the request of the administrators of the financial institution, or upon the request of the liquidator.

Conditions and Requirements for Triggering the Extrajudicial Liquidation

The BCB may decree the extrajudicial liquidation when:

- There are events that compromise the economic or financial situation of the financial institution, especially when the institution fails to timely comply with its obligations or when any of the triggering events of a bankruptcy arise;
- The financial institution’s management severely violates the by-laws and legislation that are applicable to the financial institution, or violates any of the determinations made by the BCB or the National Monetary Council;
- The financial institution suffers damages that subject its unsecured creditors to abnormal risks;
- The financial institution’s license is revoked and the responsible parties do not commence its ordinary liquidation within 90 days or, if a liquidation is commenced, its slow pace may expose the creditors to losses;
- The financial institution’s administrators request it (if properly empowered by the by-laws of the entity); or
- The liquidator justifiably requests it.

Main Consequences Arising from the Extrajudicial Liquidation

Management of the Business

The BCB appoints an individual who will act as liquidator and have full powers to manage and liquidate the entity, and specifically to verify and classify the claims against it, retain and dismiss employees, and represent the financial institution in or out of court.

The liquidator may also finalize pending transactions (if beneficial to the estate) and encumber or sell its assets (under public auctions).

The liquidator must prepare a report or a proposal within 60 days. The BCB, in view of this report or proposal, may authorize the liquidator to:

- Continue with the extrajudicial liquidation; or
- File for the bankruptcy of the entity when its assets are not enough to back at least half of the amount of the unsecured claims, or there are grounds for suspicion of bankruptcy crimes.

Mandatory Stay

The decree of the extrajudicial liquidation will immediately cause the following effects:

- Suspension of lawsuits and foreclosures initiated against rights and interests related to the assets of the entity, with a prohibition against filing new lawsuits or foreclosures against the entity while the liquidation is outstanding;
- Early termination of all obligations of the entity;
- Revocation of penalty clauses of unilateral agreements that were terminated early in view of the extrajudicial liquidation;
- Interest will stop accruing while the debts of the entity are not fully settled;
- Interruption of the statute of limitation period related to the obligations of the entity;
- Non-enforceability of monetary adjustment of any debts and of monetary penalties arising under criminal or administrative laws.

**Non-Sale Lien on the Assets of the Administrators of the Financial Institution**

The administrators of financial institutions subject to intervention, extrajudicial liquidation or bankruptcy will have all their personal assets encumbered with the prohibition against sale or other disposition ("non-sale lien"). Therefore, the administrators of a financial institution that is subject to Financial Institutions Insolvency Procedures may not, by any means, directly or indirectly, alienate, sell or encumber their own assets until the final investigation and liquidation of their liabilities.

(a) The non-sale lien results from the decree of the intervention, extrajudicial liquidation or bankruptcy, and affects all administrators that acted as such during the 12 months prior to the decree;

(b) The non-sale lien may be extended to the following assets:

(i) Assets of the managers, audit committee and all those persons who have contributed to the advent of the intervention or extrajudicial liquidation during the 12 months prior to the decree, limited to the estimated responsibility of each;

(ii) To the properties of the persons who, in the last 12 months, have acquired such assets from the managers or from the persons listed above, provided that there is undisputable proof that such acquisition was made with a fraudulent intent in order to avoid the effects of Insolvency Procedures;

(c) The non-sale lien should not be imposed on: assets that are encumbered with clauses that prohibit their judicial attachment or sale; and assets that are the subject of sale agreements, promise to sale agreements, sale or promise of assignment, provided these agreements have been registered by the appropriate Notary Public Registry, before the decree of the intervention, extrajudicial liquidation or bankruptcy;

(d) Those persons whose assets are affected by the non-sale lien are not allowed to leave the place of the jurisdiction of the intervention, extrajudicial liquidation or bankruptcy without the prior and express authorisation of the BCB or the bankruptcy judge.

**Set-Off during the Extrajudicial Liquidation**

The same as in bankruptcy (see above).

**Clawback Period**

The act of the BCB that decrees the extrajudicial liquidation shall indicate the date on which it began and set forth the clawback period, which is not more than 60 days counted as of the
first protest or from the date on which the intervention or extrajudicial liquidation was declared.

**Priorities and Privileges in the Payment of the Debtor's Obligations**

The same as in bankruptcy (see above).

**Rights of Secured and Unsecured Creditors**

The liquidator publishes in the official gazette and in a newspaper of wide distribution, a notice for the creditors to inform their respective claims (creditors of bank deposits and holders of letters of exchange issued by the financial institutions are not obliged to provide for this information), within a term not less than 20 days but not longer than 40 days (depending on the type of credit). There are subsequent procedures aimed at defining and setting the final list of creditors and respective claims, which are beyond the scope of this Guide.

**Approximate Length and Termination of the Extrajudicial Liquidation**

There is no definitive term; it may take anywhere between two and 10 years depending on the complexity of the transactions of the financial institution.

**Temporary Special Administration Regime**

**Purpose of the Temporary Special Administration Regime**

The Temporary Special Administration Regime ("RAET") is a special proceeding that is regulated by Decree Law No. 2,321/87 and is very similar to intervention.

The main difference is that this proceeding neither interrupts nor suspends the current activities of the bank and allows:

- The corporate restructuring of the financial institution; and
- The Federal Government to expropriate the distressed financial institutions.

The RAET has been applied by the BCB in the past, but only in respect of financial institutions to which bankruptcy could cause a systemic risk.

**Conditions and Requirements for Triggering the RAET**

The RAET may be declared when any of the following is present:

- Repeated banking practices that violate the provisions of economic and financial policies set forth by law;
- Negative net worth;
- Violation of rules regarding compulsory deposits with the BCB;
- Bad or fraudulent management of the entity; or
- Any event that could trigger the intervention (see above).

**Parties that May Initiate the RAET**

The BCB.
Main Consequences Arising from the RAET

Management of the Bankrupt Party’s Business

The most important effect of the RAET is the substitution of the management bodies of the financial institution by a directorship council appointed by the BCB, with broad management powers to recover the financial institution. The longevity of such a board of directors is limited, and it may be transformed in intervention or extrajudicial liquidation.

Mandatory Stay

The financial institution’s activities remain the same and the contracts are not terminated or accelerated.

Set-Off during the RAET

Not applicable because business should continue as usual.

Clawback Period

Not applicable.

Approximate Length and Termination of the RAET

Termination of the RAET

The RAET will cease:

- If the Federal Government undertakes control of the entity;
- In case of corporate restructuring (merger, etc.);
- When, according to the BCB, the situation of the business has been normalized; or
- If the BCB determines its extrajudicial liquidation.

Length

It is difficult to envision the length of a possible RAET. It is dependent upon the complexity of the financial institution’s transactions. In cases where the BCB has declared RAETs, the proceedings have been relatively fast (six months to one year). RAET is in fact a fast-track procedure because it is used for financial institutions in which distress may imply systemic risk. In these cases, the distressed financial institutions were subject to corporate reorganisations and the surviving businesses were sold to other banks.

Rules on International Insolvency or Insolvency of Foreign Corporations

There are no specific laws or regulations regarding international insolvency or insolvency of foreign corporations in Brazil.
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Overview and Introduction

This chapter discusses the various types of bankruptcy, insolvency and restructuring proceedings applicable in Canada.

Legislative authority in Canada is divided between the federal and provincial governments by subject matter. Constitutionally, bankruptcy and insolvency is a federal responsibility while property and civil rights fall within provincial jurisdiction. Labour and pension law, as well as contracts that create security interests or property rights, are mainly governed by provincial legislation, but the federal government has jurisdiction over those areas in certain industries deemed national in scope. Consequently, there is an application of both federal and provincial statutes in insolvency proceedings.

The insolvency regime is primarily governed by two federal statutes that apply across Canada: the Bankruptcy and Insolvency Act (the "BIA") and the Companies’ Creditors Arrangement Act (the "CCAA"). In the event of a conflict with provincial legislation, under a legal principal known as paramountcy, the provisions of the BIA or CCAA will prevail. The Winding-Up and Restructuring Act, another restructuring statute, deals primarily, but not exclusively, with financial institutions such as banks, trust or insurance companies that are in financial distress. Most reorganisations in Canada are conducted under the BIA or CCAA and this Guide will focus on those statutes. Typically, the BIA is used for less complicated restructurings or straightforward liquidations of assets. The CCAA is used for more complex restructurings and those requiring more time to be completed. In addition, the recently enacted Wage Earner Protection Program Act (the "WEPPA") deals with certain employee wage priorities in the context of a bankruptcy or receivership.

The BIA applies to a broad range of entities including individuals, corporations, cooperatives, partnerships, income trusts, and estates of deceased individuals. The CCAA applies to companies incorporated under federal or provincial law, or incorporated outside Canada but doing business or with assets in Canada, and income trusts. This guide will use the terms “individual” and “company” when discussing who may make use of the BIA and CCAA.

The BIA represents the most complete code, providing substantive provisions dealing with, *inter alia*, the scope and breadth of stays of proceedings, distributional priorities, fraudulent transfers, the sale of assets, the treatment of contracts, interim financings, cross-border proceedings and penalties and sanctions against debtors and their directors for violations under the BIA. The BIA also contains provisions dealing with the appointment of receivers and the rules regarding their conduct. The CCAA is a more flexible statute than the BIA, as it is designed to allow courts more discretion in assisting restructuring corporations. Like the BIA, the CCAA also has substantive provisions dealing with the scope and breadth of stays of proceedings, distributional priorities, fraudulent transfers, sales of assets, the treatment of contracts, interim financings, and cross-border proceedings.

In 1992 and 1997, major reforms to the insolvency regime in Canada placed increased emphasis on encouraging restructuring rather than bankruptcy. The past decade has seen further review of the insolvency and restructuring laws in Canada in an effort to determine whether such laws were meeting their objectives. The culmination of this review was a number of significant reforms which came into force on 7 July 2008 and 18 September 2009. Overall, the recent reforms reflect a codification of existing practices, but there are also significant new protections for workers and pensioners affected by corporate insolvencies.
Corporate Legislation

Each of the federal government and the 10 provinces has its own legislation creating and regulating corporations. For example, the Canada Business Corporations Act (the “CBCA”) is the federal act respecting Canadian business corporations, whereas in Ontario, the provincial act for business corporations is the Business Corporations Act (the “OBCA”).

These statutes contain provisions to establish and govern corporations created thereunder, while also imposing certain restrictions on actions that corporations can take while insolvent as well as actions (such as issuing dividends) that would render the corporation insolvent.

Both provincial and federal legislation also impose liabilities on officers and directors of a corporation for their actions or omissions in contravention of the statutes and their provisions.

Judicial and Regulatory Framework

Unlike in some jurisdictions, including the US, there is no separate bankruptcy court in Canada. Rather, the provincial Superior Court(s) of each province are vested with bankruptcy and insolvency jurisdiction by virtue of the federal statutes.

The Supreme Court of Canada is the final court of appeal in Canada and hears appeals from all provincial courts of appeal and the federal Court of Appeal. Parties seeking to appeal to the Supreme Court of Canada in most circumstances must seek leave to do so, as there is no automatic right of appeal with respect to matters involving bankruptcy, insolvencies and property rights.

The Office of the Superintendent of Bankruptcy (“Superintendent”), which forms part of the federal Ministry of Industry and Trade, has a general supervisory function over all bankruptcies and all matters to which the BIA applies. The other administrative official is the official receiver: employees of the Superintendent appointed across Canada to deal with the administrative obligations specified by the BIA, such as accepting the documents that are filed in connection with bankruptcy or proposal proceedings as well as monitoring proceedings to determine whether any offences under the BIA have been committed by a bankrupt.

Trustee in Bankruptcy

The Superintendent licences and regulates those persons, primarily accountants, who have undergone specialised training to become a trustee in bankruptcy (the “trustee”). The formal role of accountants is a legacy of the UK tradition which underpins Canadian law and is an important point of difference between US and Canadian insolvency practice. The trustee is the main actor in the Canadian insolvency system and is charged with administering bankruptcies and monitoring insolvency proposals and CCAA restructuring proceedings.

Types of Insolvency Administrations

The typical personal insolvency options are:

1. Bankruptcy, which entails a liquidation and distribution of assets followed by a discharge from debts at the time of the bankruptcy;
2. Proposal to creditors for a binding compromise of debts at the time the proposal is made; or
3. Consumer proposal for a fast-track binding compromise of debts for individuals with lower debt levels.
For an insolvent company, there are more insolvency options available:

(i) Bankruptcy with the liquidation and distribution of assets, but without any discharge from debts;
(ii) Proposal to creditors;
(iii) Liquidation or restructuring under the CCAA; or
(iv) Court or private receivership proceedings for liquidation and distribution of assets.

These different insolvency proceedings may take place at the same time or run consecutively. For instance, an unsuccessful proposal will result in an automatic deemed bankruptcy of the corporation or individual. It is also common for a receiver to be appointed during or following a proposal, bankruptcy or CCAA proceeding in order to carry out certain goals for secured creditors, such as interim asset preservation or marketing and sale of assets.

Definition of Insolvent Person

An insolvent person, as defined under the BIA, is any individual or company that resides, or has property or business, in Canada, has liabilities to creditors exceeding CAD 1,000, and:

(i) For any reason is unable to meet its obligations as they generally become due;
(ii) Has ceased paying current obligations in the ordinary course of business as they generally become due; or
(iii) Whose aggregate property is not, at a fair valuation, sufficient, or - if disposed of at a fairly conducted sale under legal process - would not be sufficient to enable payment of all obligations, due and accruing due.

“Person” has an expansive definition and is defined in the BIA as meaning an individual or natural person, a partnership, an unincorporated association, a corporation (which includes income trusts), a cooperative society or an organisation; the successors of a partnership, association, corporation, society or organisation; and the heirs, executors, liquidators of the succession, administrators or other legal representatives of a person, according to the law of that part of Canada to which the context extends.

The CCAA does not define “insolvency,” and the term has been given a broader meaning than set out in the BIA to include, for example, a corporation not insolvent but on “the eve of insolvency”, to enable greater restructuring opportunities under the CCAA.

Meaning of Bankrupt

To be bankrupt in Canada denotes a legal state wherein a debtor has lost the debtor’s title, equity and rights in and to the debtor’s assets in favour of a trustee that is appointed and in whom the title to, and equity and rights in connection with the assets of the debtor-bankrupt, are vested.

The BIA sets out that only a “debtor” that is an insolvent person may become bankrupt.

The Bankruptcy and Insolvency Act (“BIA”)

The purpose of the bankruptcy regime is to allow the bankrupt entity protection from creditors and provide for the orderly and fair liquidation and distribution of the bankrupt’s assets to creditors.
Upon bankruptcy, a trustee becomes vested (whereby ownership is transferred by operation of law) with all of the bankrupt's property that is subject to the bankruptcy. The trustee’s rights in the property are subject to the interests of third parties including secured creditors (which generally include lessors under perfected finance leases) and property owners (which generally include lessors under true rental leases). Although the trustee’s rights are subject to those of secured creditors and property owners, and even though secured creditors and property owners are not typically stayed by a bankruptcy, the trustee can require any party claiming rights in an asset in the possession of the trustee to prove its claim in accordance with specified BIA procedures. Until those procedures are exhausted or the trustee consents, the trustee is entitled to remain in possession of the property in issue.

The trustee’s primary duties are to collect, preserve and sell the assets of the bankrupt, and to distribute available proceeds to creditors in accordance with their prescribed priorities and pro rata within each class of creditors. The trustee must also investigate the affairs of the bankrupt and transactions entered into prior to bankruptcy.

The BIA provides a broad stay of proceedings which applies to all creditors, aside from secured creditors exercising rights to enforce against their security. In certain circumstances, the stay of proceedings may be lifted to permit actions by creditors to proceed. This chiefly happens in situations where there are allegations which, if proven, would survive bankruptcy, such as the bankrupt obtaining property by false pretences, by fraudulent misrepresentation or by fraud while acting in a fiduciary capacity. In limited circumstances, the stay of proceedings may be extended to a secured creditor realising its security where the trustee seeks an alternative method of liquidation that would yield recovery for unsecured creditors after the secured creditor is paid in full.

The procedures involved in a corporate bankruptcy are similar to those for individuals. Bankruptcy can occur voluntarily as a result of an insolvent debtor filing an assignment in bankruptcy, or involuntarily as a result of a creditor filing a bankruptcy application in respect of an insolvent debtor.

Voluntary Bankruptcy

The most common way for an individual or company to become bankrupt is by making a voluntary assignment into bankruptcy. A voluntary assignment requires an application to the official receiver on a prescribed form which nominates a trustee to administer and distribute the assets of the bankrupt to creditors. Bankruptcy comes into effect on the date of acceptance by the official receiver. No application needs to be made to a court.

Involuntary Bankruptcy

Bankruptcy may be initiated involuntarily through court action by a creditor or creditors whose claim exceeds CAD 1,000 and where an act of bankruptcy has been committed. An application for a bankruptcy order must set out the debt owed by the debtor, the proposed trustee, and the act of bankruptcy that the creditor believes has been committed. The typical act of bankruptcy alleged is generally failing to pay debts when they are due, but it can also include the giving of preferences to other creditors and fraud. The bankruptcy application can be disputed, in which case an expedited trial of the issues is set to decide whether an act of bankruptcy has been committed.

Discharge from Bankruptcy

An individual first-time bankrupt who is not classified as a tax debtor will, provided he attends mandatory debt counselling, receive a discharge nine months after the date of bankruptcy unless: (i) an opposition to the discharge is filed; or (ii) the bankrupt has surplus income, in which case, he will receive an automatic discharge after 21 months. An individual with a
personal tax debt in excess of CAD 200,000 that represents more than 75% of total creditor claims will be classified as a tax debtor and not be eligible for an automatic discharge. An individual bankrupt who is not entitled to an automatic discharge must make an application to court. A court hearing (usually before a subordinate judicial officer known as a bankruptcy registrar) will be held to determine the terms of the bankrupt’s discharge or whether the discharge should be refused because of conduct by the bankrupt. Typically, either financial or conduct conditions will be imposed on the bankrupt. A discharge is normally refused only in cases of serious misconduct by the bankrupt, such as hiding assets or subverting the rights of creditors. A discharge operates to release the individual from all debts that were provable in bankruptcy except secured debts and debts that survive bankruptcy.

A corporate bankrupt cannot receive a discharge from bankruptcy unless it pays all of its debts in full or makes a successful proposal to its creditors.

Discharge of the Trustee

The trustee can apply for discharge, once he has realised on all the realisable property of the bankrupt and otherwise completed the administration of the bankruptcy and the trustee’s duties under the BIA. If there are any remaining unrealisable assets of the estate, the trustee may obtain the approval of the inspectors who are elected by the creditors (see below) to return the assets to the bankrupt or may dispose of the assets in another manner by way of a court order. When the trustee is discharged, he has no further duties under the BIA and receives a discharge against any liabilities for his conduct other than fraud.

Proposals to Creditors

A proposal is a relatively flexible method available to an individual or company to restructure financial obligations rather than simply filing for bankruptcy. Once approved by the requisite majority of creditors and then by the court, the proposal becomes a contract binding both the debtor and all creditors whether they voted in its favour or not.

With the assistance of a trustee, an insolvent company can initiate a BIA proposal restructuring by filing with the official receiver either a notice of intention to make a proposal ("NOI") - a form indicating that the company intends to make a proposal to creditors - or a proposal itself, i.e. a document detailing the proposed reorganisation plan. Generally, a NOI is filed first and then the proposal is finalised after negotiating with creditors over its terms.

The advantages for a company making a proposal for a corporate restructuring are that it: (i) has protection from its creditors (including secured creditors) through a stay of proceedings; (ii) continues to operate its business; and (iii) remains in possession of its property. The initial stay is only 30 days, but where the restructuring company is able to satisfy the court that a restructuring is potentially viable, extensions of the stay for up to an additional five months are obtainable. In a restructuring under a proposal, a trustee assists with the preparation of the proposal and is required to report to creditors and the court on the viability of the proposal and the business of the restructuring company.

In order for the proposal to succeed, the restructuring company must gain the support of more than 50% in number of the voting creditors in each class of creditors, representing at least two-thirds in value of the claims in the class, as well as the approval of the court (which is usually granted if the proposal has been approved by creditors). There is an automatic deemed bankruptcy if the proposal fails to gain the approval of either the creditors or the court.

The more common types of proposals include a cash settlement proposal, which provides a pay-out of some amount on a pro rata basis to outstanding claims, either as a lump sum or over time; and a liquidation proposal, which provides for the orderly liquidation and sale of
the assets of a business (often a new start-up entity) with the proceeds of sale then being shared amongst creditors.

If the proposal is approved, the company will enjoy its benefits so long as all its terms are implemented as promised. If the company defaults in its performance of the proposal terms, a bankruptcy can result.

**Consumer Proposals**

Consumer proposals were introduced into the BIA to allow individuals with relatively small amounts of unsecured debt to have access to an inexpensive and expedited procedure to make a proposal to their creditors. The debt limit for a consumer proposal is CAD 250,000 (excluding any mortgages on the individual's principal residence). The main difference from a regular proposal is that there is a deemed acceptance of the consumer proposal unless creditors representing 25% of the claims against the individual request a meeting of the creditors. There is an automatic deemed bankruptcy upon a default in the performance of an accepted consumer proposal.

**Disclaimer and Resiliation of Contracts**

The 2009 amendments to the BIA provide that a debtor may disclaim or resiliate (i.e., terminate) certain contracts to allow for a successful restructuring. The disclaimer or resiliation must enhance the prospect of a viable restructuring and not merely be convenient for the debtor to get rid of a contract.

Any contract may be disclaimed or resiliated, with the exception of:

(i) An eligible financial contract;

(ii) A collective agreement (i.e. a collective bargaining agreement);

(iii) A financing agreement if the debtor is a borrower; or

(iv) A lease where the debtor is the lessor.

The debtor must first obtain the approval of the trustee, and if the trustee approves, a notice of the disclaimer or resiliation is sent to the contract counterparty. The counterparty may seek to overturn the debtor’s disclaimer or resiliation by appealing to the court within 15 days. Any loss suffered as a result of the disclaimer or resiliation becomes a provable claim in the proposal. Any executory contract that is not disclaimed or resiliated will remain in full force and effect during a NOI or proposal proceeding.

**Assignment of Contracts**

Under the BIA, a debtor in the midst of a NOI or proposal may seek a court order assigning to another party the debtor’s rights and obligations under an agreement. Only business debtors or individuals who carry on business and seek assignment of a business agreement may seek such an order. Any business agreement is potentially assignable except an agreement entered into after the filing of a proposal or the NOI (whichever came first), an eligible financial contract, or a collective agreement. Moreover, the court may make such an order only if it is satisfied that all monetary defaults in relation to the agreement - other than those arising by reason only of the person’s bankruptcy, insolvency or failure to perform non-monetary obligations - will be remedied on or before the date fixed by the court.
In deciding whether to make such an order, the court must consider:

(i) Whether the person to whom the rights and obligations are to be assigned is able to perform the obligations;
(ii) Whether it is appropriate to assign the rights and obligations to that person; and
(iii) Whether the proposal trustee approved the proposed assignment.

Sale or Disposition of Assets under the BIA

During a NOI or proposal proceeding, a debtor may remain in control of its assets and operations and can sell or dispose of assets in the ordinary course, or alternatively a trustee or receiver may be appointed. Sales or dispositions out of the ordinary course are prohibited unless the debtor complies with the recently enacted regime under the BIA.

Where a debtor wishes to dispose of business assets out of the ordinary course, court approval is required. Notice of the motion to approve the proposed sale or disposition motion must be given to any secured creditor likely to be affected by the proposed sale of disposition.

The court is to consider six factors when weighing whether to approve the proposed sale or disposition:

(i) Whether the process leading to the proposed sale or disposition was reasonable under the circumstances;
(ii) Whether the trustee approved the process leading to the proposed sale or disposition;
(iii) Whether the trustee filed a supportive report stating that in its opinion the proposed transaction would be more beneficial to creditors than a sale or disposition in a bankruptcy;
(iv) The extent to which creditors were consulted;
(v) The effects of the proposed transaction on creditors and other interested parties; and
(vi) Whether the consideration is fair and reasonable taking into account market values.

Where the proposed sale or disposition is to a related person, the court must, in addition to the above, also be satisfied that good faith efforts were made to sell to unrelated parties (i.e. there was a public sales process, etc.) and that the related person’s offer is the best (or only) offer in the process leading to the proposed sale or disposition.

The BIA defines a “related person” as a director or officer of the debtor, a person that has direct or indirect de jure control of the debtor or any person related to such persons. To the extent that the court is inclined to approve the proposed transaction, the court may authorise the sale or disposition free and clear of any charge, lien or restriction, with the proceeds to stand in the place of the assets.

The Companies’ Creditor Arrangement Act (“CCAA”)

In comparison to the structured and statute-driven process under the BIA, the CCAA is a court-driven process that offers a flexible and powerful tool for restructuring or liquidating corporations in financial difficulty. Whilst not required, it is not unusual for a single judge to...
supervise a CCAA case from beginning to end. The considerable judicial involvement and discretion under the CCAA leads to a more expensive process than under the BIA.

The CCAA has been referred to as the Canadian chapter 11, referring to US Bankruptcy Code chapter 11 proceedings, but there are important differences. For instance, CCAA protection is not automatic and there is no ability to “cram down” classes of creditors by seeking court authorisation. The absolute priority rule and equitable subordination do not exist in Canada.

The CCAA is intended for use by large corporations, but in fact the threshold requirement to initiate a CCAA reorganisation is merely that the corporation, either alone or with its affiliates, has at least CAD 5,000,000 of debt, and that each applicant is insolvent. The real bar to accessing the system for small companies is the extra cost of the court-supervised system under the CCAA.

Initial Application

CCAA proceedings are commenced by a court application by the insolvent company, but protection is not automatically granted. If the court is satisfied that the insolvent company has a reasonable prospect of restructuring, its initial order will grant the insolvent company a stay of proceedings of up to 30 days that provides comprehensive protection from creditors. Typically, the stay of proceedings is extended upon further applications by the insolvent company, often resulting in a stay period spanning many months or, in some cases, several years. There is no fixed limit on the extension of the stay of proceedings, so long as the extension is not prejudicial to the creditors as a whole and a viable process is underway.

During the stay of proceedings, the debtor company normally continues operations while it attempts to restructure. However, it is increasingly common for the senior lenders or interim financiers to require that an agreed chief restructuring officer be appointed to direct the restructuring process, since it is unusual for existing management to have the specialised expertise needed to guide a company through a successful restructuring process.

Appointment of Monitor

A key provision of the CCAA is the appointment by the court of an independent party to monitor and supervise the restructuring. The monitor is a licensed trustee whose main function is to report to the court and creditors on the business and financial status of insolvent company and to assist the insolvent company in developing a restructuring plan. Once appointed, the monitor becomes an officer of the court.

In order to fulfil its monitoring and review duties, the monitor has a right of access to the debtor’s property and books and records.

Critical Suppliers

Under the CCAA, the court may designate a critical supplier where it is satisfied that the goods or services that are supplied are critical for a viable restructuring. The critical supplier is ordered to continue to supply on terms that are consistent with the supply relationship and is granted a priority court charge over the assets and property of the debtor for the value of goods or services supplied. This is a new provision to the CCAA and not comparable to the chapter 11-style critical supplier designation where suppliers are routinely paid their pre-filing claims as a condition of post-filing supply. However, the new provision leaves open the possibility of the court ordering the payment of pre-filing debts as part of the terms of continued supply, and payment has been ordered in a very limited number of cases.
Plan of Compromise or Arrangement

The proposal that the insolvent company puts to its creditors (and sometimes shareholders) for a vote is called the plan of compromise or arrangement. There are no restrictions on what terms a plan of compromise or arrangement may include. Frequently, there is an offer to pay a fixed amount divisible amongst creditors, either as a lump sum or over time. A conversion of debt to shares is also not uncommon. The plan requires approval by a double majority (majority of creditors in the class and two-thirds of the creditors in value within that class). Creditor classes are not defined in the CCAA, but are formulated by the insolvent company and usually set out in the proposed plan of arrangement. A “commonality of interest” test is frequently used to group creditors into classes of similarly situated claims, and creditors can ask the court to revise creditor classifications if the classes are being used by the insolvent company to illegitimately swamp a dissenting group with unique rights.

Once the plan has been voted on and accepted by the creditors, the court holds a sanction hearing at which time the court reviews the fairness of the process and the plan. If there is sizable creditor support, the approval of the court is almost always given.

If a class of creditors or the court does not approve the plan, the insolvent company does not automatically go into bankruptcy. Unlike in the US, there is no right to cram down dissenting classes. It is possible for the insolvent company to submit a new or amended plan. However, in the event of non-approval, it is common that the senior secured creditor or unsecured creditors will immediately seek to lift the stay of proceedings to exercise their available remedies against the insolvent company. This typically results in the insolvent company being placed into bankruptcy or receivership or both.

Restructuring Powers

The CCAA authorises the court to: (i) approve secured debtor-in-possession (“DIP”) financing and grant a priming charge for the DIP lender, as described below; (ii) grant priority charges for professional fees related to the restructuring process; and (iii) indemnify directors and officers against post-filing liabilities to induce them to remain in office.

Disclaiming Agreements

The restructuring powers available under the CCAA include the ability of the court to order an assignment of an agreement between a third party and the insolvent company and the ability of the insolvent company to disclaim agreements with a third party if the consent of the monitor or court approval is obtained. Unlike a chapter 11 DIP in the United States, an insolvent company in Canada cannot disclaim a collective agreement under the CCAA. As under the BIA, there are other specified types of contracts that cannot be disclaimed under the CCAA.

Asset Sale

Another significant restructuring power is the ability to conduct asset sales outside of the ordinary course of business and outside the filing of a plan of arrangement. Before an asset sale will be approved, the court must be satisfied that statutorily required payments for unpaid wages and pension plan contributions will be made.

The court will consider six factors when weighing whether to approve the proposed sale or disposition of assets:

(i) Whether the process leading to the proposed sale or disposition was reasonable under the circumstances;
(ii) Whether the monitor approved the process leading to the proposed sale or disposition;

(iii) Whether the monitor filed a supportive report stating that in its opinion the proposed transaction would be more beneficial to creditors than a sale or disposition in a bankruptcy;

(iv) The extent to which creditors were consulted;

(v) The effects of the proposed transaction on creditors and other interested parties; and

(vi) Whether the consideration is fair and reasonable taking into account market values.

Assets sales to related parties are also subject to heightened scrutiny as to whether the value received is greater than what would have been received under a sale to a non-related party. The court may also authorise the sale or disposition to be free and clear of any charge, lien or restriction, with the proceeds to stand in the place of the assets.

**Interim Financing**

The CCAA allows for DIP financing for a debtor in a CCAA proceeding. The interim financing may be secured by a court order against the assets of the debtor and may rank ahead of claims of all other secured creditors (except those created by a previous court order that refused to consent to a subordination) of the debtor. Any such application must be on notice to any secured creditor that will likely be affected by any priority security or charge.

In deciding whether to make the order, the court must consider:

(i) The period during which the debtor is expected to be subject to proceedings under the CCAA;

(ii) How the debtor’s business and financial affairs are managed during the proceeding;

(iii) Whether the debtor's management has the confidence of its major creditors;

(iv) Whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the debtor;

(v) The nature and value of the debtor’s property;

(vi) Whether any creditor would be materially prejudiced as a result of the security or charge; and

(vii) The monitor’s report referred to in paragraph 23(1)(b) of the CCAA, if any.

The CCAA leaves it open to the courts to determine the scope of the priority and quantum of any interim DIP financing and charge.

**CCAA Liquidations**

The CCAA was originally intended to allow large and complex insolvent company restructurings to take place. However, jurisprudence has developed whereby the CCAA is also used as a tool to liquidate. Sometimes the liquidation leads to a plan of arrangement which provides for the distribution of the proceeds.

However, if priorities are not contested and there is not enough to pay secured creditors in full then the court may simply authorise the termination of the proceedings once the
liquidation is complete and authorise distribution to the secured creditors and other priority claimants.

Receiverships

Receivership is a remedy for the enforcement of a secured creditor’s rights in which the receiver is empowered to take possession, manage on an interim basis, and then sell the insolvent company’s property. It is possible to seek the appointment of a receiver over an individual but this is rarely done. Receiverships are common in Canadian corporate insolvencies and usually involve the liquidation of property or the sale of the insolvent company’s business as a going concern.

Where a secured creditor intends to enforce against all or substantially all of an insolvent company’s property, the BIA requires that the creditor gives a formal notice of the intention to enforce its security. This requirement imposes a 10-day waiting period on the appointment of a receiver after a secured creditor gives notice of a default entitling it to enforce its security (however, some factors under the common law may lengthen this waiting period). The purpose of this waiting period is to permit the insolvent company to either pay out to the creditor, or file for a formal restructuring under the BIA or CCAA. If the 10-day period elapses without a pay-out or the filing of a BIA restructuring, the secured creditor will not be subject to a stay if such a restructuring is later filed (the insolvent company may still, however, be able to attempt to file a CCAA application).

Receiverships can either be private, through the appointment by a secured party over the property of the insolvent company in which it has a secured interest, or court-ordered under either provincial or federal law, upon an application to the court (usually by a secured creditor). Since a bankruptcy does not generally affect the rights of secured creditors, a receivership can occur at the same time as a bankruptcy. Private receivers derive their authority from the secured creditor’s security documentation. These appointments are generally less common than court-appointed receiverships, but are less costly and still employed when in conjunction with bankruptcies.

The BIA provides for two types of receiverships. The first is an interim receiver, whose appointment is intended to be of limited duration and scope. The second is a national receiver, who can be empowered to take possession and control of all or substantially all of the property of an insolvent debtor across Canada. The national receiver is a recent addition to the BIA and is intended to carry out the functions performed by a receiver appointed under provincial statutes. Creditors may still resort to provincial appointments, but an appointment under the BIA affords a significant advantage in the enforceability of the receiver’s powers across Canada.

Informal Arrangements - Consensual Agreements

Frequently, before resorting to formal insolvency proceedings, an insolvent company will try to enter into contractual compromise or standstill arrangements with its creditors, usually involving debt repayment or deferral. The advantages of a reaching a consensual agreement with creditors include avoiding the stigma and asset-value erosion of formal insolvency proceedings and the risk of losing all assets or having an ongoing business shut down. However, it is often unrealistic to expect that a complex restructuring with divergent interests can be resolved on a consensual basis.

Informal Arrangements - “Look-see” Appointments

Before restructurings commence, a secured creditor may also, under the terms of its security agreement, appoint an informal monitor, typically a trustee. The purpose of the appointment
is for the secured creditor to assess the viability of a restructuring through a neutral and professional assessment of the debtor’s financial difficulties. Recommendations made are not binding on a debtor, but are usually followed so as to avoid losing the support of the secured creditor.

Other Specific Issues

Priority of Claims

Within each class of creditors in a bankruptcy or insolvency, the general rule is that their debts are ranked equally, and if the property of the bankrupt is insufficient to meet them in full, they will be paid pro rata.

The exceptions to the general rule are significant. Both federal and provincial statutes create super-priority statutory deemed trusts and liens relating to employee-related remittances for income taxes, employment insurance and the federal Canadian Pension Plan or provincial equivalents. Subject to statutory super-priority claims, secured creditors are entitled to deal with the collateral of the debtor secured to them. Property that is exempt from seizure in the province in which the property is located and within which the bankrupt resides does not become part of the bankruptcy.

BIA Section 38 Proceedings

Section 38 of the BIA provides a powerful tool for creditors of a bankrupt to acquire and pursue a right or chose in action to recover assets or value owing to an estate, where a trustee refuses or neglects to act.

Where the trustee chooses not to act to pursue a right to recover an asset of the estate, often where the costs to recover the asset are prohibitive, the creditor may apply to the court under section 38 of the BIA to be able to take an assignment of that right and pursue it for the creditor’s direct benefit.

Super-priority for Unpaid Wage and Pension Claims

The BIA and CCAA provide that the court may approve a reorganisation or grant authorisation for interim asset sales only if it is satisfied that the restructuring company can and will make the payments that are statutorily required for unpaid wages as well as for unpaid pension plan contributions.

WEPPA now also gives certain employees’ wage claims (such as for wages, vacation pay, and severance and termination pay), in the context of a bankruptcy or receivership, up to a certain amount, a higher priority than secured creditor claims.

Equity Claims

Claims arising from the purchase or sale of equity of an insolvent company are subordinated to all other claims. No proposal or plan of arrangement that provides for payment of an equity claim may be approved by the court unless all other claims are to be paid in full.

Notwithstanding the general prohibition, shareholders have some prospects for recovery by taking advantage of the ability to preserve and sell tax losses in restructured companies.

Transfers at Undervalue, Preferences and Fraudulent Conveyances

The BIA and CCAA both provide mechanisms for scrutinising transfers where the consideration received by the debtor is “conspicuously less” than the fair market value.
There are broad powers with respect to transfers to non-arm’s-length parties. There is also provincial legislation on this topic which is applicable in all insolvency scenarios.

Each of the aforementioned statutes operates in its own way with its own terminology, but all can be used in some circumstances to attack transactions, including the granting of security, which have the effect of preferring one creditor or party over other stakeholders. Most of the statutes only apply where the transaction in question occurs when the debtor is insolvent or on the eve of insolvency. Some of the statutes only apply only where the primary intention behind the transaction is to prefer the creditor (as opposed to obtaining financing, purchasing assets, etc.). The intent requirement significantly limits their applicability in practice. Further, the exchange of fair market value consideration (in this case, financing to acquire an asset) in a good-faith transaction is generally a complete defence to an attack. In essence, these statutes are primarily focused on unwinding strategies to diminish the estate, usually involving insiders, and not on arm’s-length transactions or good-faith financing. Nevertheless, it is always wise to evaluate any proposed transaction against the tests in these statutes at the time of entering into them.

Rights of Reclamation of Property

The BIA allows creditors under certain circumstances to recover goods sold to a bankrupt within 30 days of the bankruptcy. Of considerable note is that a strict and timely process must be followed by a creditor who wishes to recover its goods, namely:

(i) A creditor must have sold goods, delivered same, and not been fully paid for those goods;

(ii) The creditor must present written demand, in the prescribed form, within 15 days of the purchaser becoming bankrupt or subject to a receivership;

(iii) The goods must have been delivered within 30 days of the bankruptcy; and

(iv) At the time of the demand, the goods must be in possession of the purchaser (or trustee or receiver), identifiable, in the same state as delivered, and have neither been sold by the purchaser nor become the subject of an arm’s-length agreement of purchase and sale.

Rights of Set-Off

Under the BIA, the law of set-off applies to all claims against the bankrupt and to all actions instituted by the trustee for recovery of debts due to the bankrupt, in the same manner and to the same extent as if the bankrupt were either a plaintiff or defendant, as the case may be. The BIA permits a creditor, who is also a debtor to the bankrupt on another account, to claim the right of set-off against such amount.

The CCAA provides that the law of set-off applies to all claims made against the insolvent company and to all actions by the insolvent company to recover money.

Lifting the Stay of Proceedings

The BIA also affords a creditor the opportunity to apply to the court to seek to lift the stay of proceedings where the court is satisfied that the creditor is likely to be materially prejudiced if the stay is continued or there are other equitable grounds to do so.

“Materially prejudiced” generally involves situations where the creditor’s claim is otherwise not dischargeable in bankruptcy or involves a situation where the bankrupt is a necessary party to adjudicate a matter that involves other parties.
Cross-Border Insolvencies

Canada adopted a modified version of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency in the 2009 amendments to the BIA and CCAA. Part XIII of the BIA and Part IV of the CCAA aim to provide mechanisms for dealing with cross-border insolvencies and to promote:

(i) Cooperation between the courts and other competent authorities in Canada with those of foreign jurisdictions in cases of cross-border insolvencies;

(ii) Greater legal certainty for trade and investment;

(iii) Fair and efficient administration of cross-border insolvencies that protects the interests of creditors, other interested persons and debtors;

(iv) The protection and the maximisation of the value of debtors’ property; and

(v) The rescue of financially troubled businesses to protect investment and preserve employment.

Classification of a Foreign Proceeding

The starting point under both the BIA and CCAA is an application for recognition of a foreign proceeding by a foreign representative. The representative, who is appointed in the foreign proceeding, applies to the Canadian courts to have the foreign proceeding recognised under either Part XIII or Part IV.

The definition of “foreign representative” differs in the BIA and CCAA, with the CCAA definition being focused on monitoring for the purpose of reorganisation. Both definitions, however, contemplate the appointment in the foreign proceeding of a person as the foreign representative.

There is a subtle difference in the application of Part XIII of the BIA and Part IV of the CCAA, with the latter being aimed at foreign proceedings for the purpose of reorganisation only and the BIA being aimed at foreign proceedings for the purpose of either liquidation or reorganisation.

The BIA defines “foreign proceeding” as a judicial or an administrative proceeding, including an interim proceeding, in a jurisdiction outside Canada dealing with creditors’ collective interests generally under any law relating to bankruptcy or insolvency in which a debtor’s property and affairs are subject to control or supervision by a foreign court for the purpose of reorganisation or liquidation. This definition is broad enough to include liquidation proceedings, reorganisation proceedings and receiverships. The CCAA defines “foreign proceeding” more narrowly insofar as it is limited to proceedings that are for the purpose of reorganisation.

Under the BIA and the CCAA, the Court is required to make an order recognising the foreign proceeding if the foreign representative satisfies the Court that the proceeding is a foreign proceeding and that the applicant is the foreign representative appointed in that proceeding.

Further Classification of a Foreign Main Proceeding or Foreign Non-Main Proceeding

A foreign proceeding must be recognised as either a “foreign main proceeding” or a “foreign non-main proceeding”. A foreign main proceeding is a proceeding that is commenced in the jurisdiction where the insolvent company has its centre of main interest (often referred to as “COMI”) and a foreign non-main proceeding is a proceeding in any other jurisdiction. A
A foreign proceeding that is not a foreign main proceeding is a foreign non-main proceeding.

Recent Trends

Distressed Mergers & Acquisitions

The traditional debtor's reorganisation plan is often replaced by a management led pre-packaged sale of a financially distressed company as a going concern, the proceeds of which are then used to make a proposal to creditors.

Under a distressed scenario, a company typically commences efforts to sell the business. It then files for CCAA protection, after which management of the debtor company has the breathing space necessary to continue in its efforts to sell the company. The company is marketed as a going concern, as opposed to a liquidation, with job preservation being a fundamental driver and factor in the court approval process. Once a buyer is found, the court approves the sale transaction (without shareholder or bulk sales act approval) and issues a vesting order, vesting title in the assets to the buyer free and clear of all liens, security interests and encumbrances all of which are transferred to the proceeds of sale.

Recently, Canadian courts have adopted the US concept of “stalking horse” bid procedures to sell distressed businesses. Under this process, the distressed company engages in a sale process, selects a stalking horse bid and enters into an agreement of purchase and sale with the stalking horse bidder which is approved by the court. The court also approves an auction process to market test the initial bid. Subsequent bidders’ offers are based on substantially similar terms as the stalking horse agreement of purchase and sale and the purchase price must be greater than the stalking horse purchase price by a defined amount. If another bid is accepted, then the stalking horse bidder receives a break fee and expense reimbursement for the lost deal.

Restructuring using the Canadian Corporate Statute

Recently, the Canada Business Corporations Act (“CBCA”) has been used as an alternative to the CCAA, to implement certain types of restructurings. Although the CBCA is not fundamentally an insolvency statute, section 192 of the CBCA establishes a statutory procedure by which a company can seek court approval for an arrangement that effectively implements a restructuring.

The advantages of a CBCA restructuring process over a CCAA restructuring process are that it is generally cheaper, faster, does not involve all of the creditors (just debt and equity), and has less stigma associated with it. In addition, equity holders have a greater chance of preserving some value, versus in a CCAA restructuring where equity is at risk of being wiped out entirely. The major differences include that the CBCA is used to implement exclusively a financial restructuring.

Under section 192 of the CBCA, only those companies that satisfy the statutory three-part test (meet the statutory requirements, put forward the arrangement in good faith and that the arrangement is fair and reasonable) can obtain court approval for a plan of arrangement. Although section 192 states that a corporation must not be insolvent to avail itself to the provision, courts have permitted insolvent companies to participate in an arrangement where one or more parties applying for court approval were solvent, or alternatively, where the insolvent applicant would be solvent after completing the arrangement. Further, courts only approve a section 192 arrangement if it is fair and reasonable. This requires a determination
of “whether the court may conclude that an intelligent and honest business person, as a
member of the class concerned and acting in his own interest, might reasonably approve of
the plan”.

Pension Restructuring

Large pension plan solvency deficiencies have been prevalent in recent years as a result of
debts in the market value of pension plan assets largely due to the persistently low
interest rate environment. This placing of additional cash flow demands on companies
already tight for cash has had the domino effect of pushing many companies into bankruptcy
and insolvency proceedings.

In Canada, an employer generally has two types of pension plans, a defined benefit pension
plan and a defined contribution pension plan. A defined benefit pension plan is one in which
the pension payments that an employee will receive are based on a formula calculated by
actuaries based on factors such as average salary and years of service. The idea is that an
employee is guaranteed a defined amount upon retirement. A defined contribution plan, on
the other hand, is one where an employer makes yearly contributions based on a fixed
percentage of the employee’s earnings. There is no guarantee or promise about what an
employee will receive when they retire. The funds are invested by the employer and when
the employee retires, he will receive an annual pension from the fund.

A term frequently coming up in recent Canadian insolvencies is “solvency deficiencies” and
the need for companies to remit “special payments” in addition to “normal payments”. A
solvency deficiency exists only under defined benefit pension plans (defined contribution
plans are not underfunded because once an employer makes normal contributions, the plan
is fully funded) where the plan liabilities exceed the plan assets. Special payments are
required to be made when a solvency deficiency is identified. These liabilities can be
significant and often drive the need for a company to seek restructuring protection under the
CCAA.

Through a CCAA filing, typically ongoing special payments and arrears are suspended. The
company just makes normal payments. Often a filing enhances a company’s ability to better
negotiate with the unions, pension regulator and plan administrator for the restructuring of
the pension plan.

Rise of Unions as Key Players

Unions, pension regulators and pension administrators have more recently become key
players in CCAA restructurings as a result of the increase in restructurings involving pension
related issues. These players are present throughout the entire process and often even
before.

Environmental Claims

At the forefront of Canada’s biggest CCAA filings in recent years has been the controversy
over a company’s responsibility for claims by government regulators for environmental
clean-up. Government authorities are aggressively pursuing both the debtor company and its
directors through the courts in an effort to prevent the debtor from passing on the cost of
remediation to third party creditors in a CCAA proceedings. Recent cases have held that
environmental orders issued by regulatory authorities that are found to be monetary in
nature will be found to be provable claims and hence subject to the CCAA claims process
and stayed and compromisable.

The recent cases illustrate that, subjecting environmental orders to the insolvency process
does not extinguish the liability of a CCAA debtor, but protects the polluter pay principle, by
ensuring that regulators are not given super priority that would effectively pass the cost of remediation on to third party creditors.

However, recently, the government authorities have used a combination of environmental tribunals and CCAA proceedings to target the directors who ultimately approved a CCAA filing without making prior arrangements to fund a previously identified contaminated site. Even though some of the directors in question were not directors when the contamination occurred, a lower court ultimately held a group of directors liable for remedial costs, and before the case could be heard on appeal, the directors reached a significant settlement agreement with the government.

As a result, these recent trend of cases serve as warning to debtor companies and the directors, particular, directors of insolvent or near-insolvent companies of the risk of personal liabilities where there are outstanding environmental obligations.

Additional Cross-Border Observations

Some of the features of the Canadian insolvency landscape that are worth noting include the following.

Pace of Proceedings

The pace of proceedings in Canada is generally quicker than in the United States. This speed of action tends to favour secured creditors and property owners by keeping restructuring processes short and by preventing assets from being trapped for extended periods of time inside insolvency estates.

Support of Major Financiers

It is much more difficult for a debtor to restructure without the support of its major financiers. There are many reasons for this, including an underlying finance-friendly culture and the legacy of the United Kingdom’s commercial law and its tradition of protecting domestic banks.

No Creditors’ Committees in Canada

Another difference between American and Canadian practice is that there are effectively no creditors’ committees in Canada. In a bankruptcy, at the first meeting of creditors, a form of creditors’ committee is elected (the “inspectors”). However, the inspectors have no right to funding from the estate, no standing in court as a committee, and no independent power to manage the estate or initiate litigation. They therefore tend to play a very limited role. In CCAA proceedings, there is judicial discretion to create and fund committees, but it is still an exceptional remedy, rather than the rule.
Chile

Overview

Chile has recently adopted a major reform to restructuring and insolvency, in terms of its regulations, institutions and procedures, by means of the publication of the Law of Insolvency and Re-Entrepreneurship, Law No. 20,720, on January 9, 2014. This law replaces in its entirety the existing Law No. 18,175, which dated back to 1982, and has been subject to several amendments in past years. The new regulation came into force in October 2014.

Introduction

The Law of Insolvency and Re-Entrepreneurship provides for a completely new set of rules for reorganisation and liquidation, including new proceedings, among which the new debt reorganisation proceeding for companies and for individuals is especially noteworthy. Some other important modifications include the utilisation of new auxiliary officers in a bankruptcy or insolvency procedure (trustees or “síndicos” are replaced by liquidators or “liquidadores” and observers or “veedores”, with new powers), and new relevant authorities (the Bankruptcy Superintendence is to be replaced by a new agency, the Superintendence of Insolvency and Re-Entrepreneurship).

Law No. 20.720 establishes new rules for reorganisation and liquidation, eliminating the concept of bankruptcy, with the purpose of making the corresponding procedures simpler, more efficient, more flexible, and shorter, with different sets of rules for individuals and companies. Following are some of the most important features of the new law.

Judicial Reorganisation Procedure for Companies

This new procedure is established in order to increase the possibility of an insolvent company achieving an agreement with its creditors that may allow it to pay its debts, in order to avoid bankruptcy. In the event that this procedure fails, or the agreement is not fulfilled, the general consequence is that a liquidation procedure is triggered against the debtor company.

The reorganisation procedure begins by means of a request by the debtor company to the court. With that request, the company must also make a presentation to the Superintendence in order for it to appoint an observer (“veedor”), an officer whose main duty is to promote an arrangement between the debtor company and its creditors for the payment of the debts. The observer is appointed by the Superintendence, taking into consideration the name(s) proposed by the three largest creditors of the debtor company. If those creditors propose different observers, the one proposed by the largest creditor shall be appointed.

Once the observer’s nomination has been accepted, the Superintendence will notify the competent court, and the debtor shall submit to the court the following documents:

- A list of all its assets;
- A list of third-party assets given as guaranty in favour of the debtor;
- A list of third-party assets which are in the debtor’s possession;
- Certificates that give account of existing debt and identify the creditors; and
- Debtor’s balance sheet.
With this presentation, the court issues the Reorganisation Resolution ("Resolución de Reorganización") by means of which the procedure formally begins. The Reorganisation Resolution will contemplate, among other things, the following:

- For a 30-day term, extendable for another 30 or 60 days, the debtor company will be granted Financial Insolvency Protection. During this term, no requests for liquidation may be presented against the debtor, no enforcement proceeding can commence against it (and the ones currently in course are suspended), and the debtor may not be eliminated from public registries in which it is listed as a contractor or service provider. Further, during this term, all contracts entered into by the debtor company will remain in force with the same payment conditions. Hence no early termination or acceleration clauses may be enforced against the debtor based on the starting of a Reorganisation Procedure (if any creditor does so, their credit will lose all preference for payment and will be paid after the payment of the credits to all other creditors, including creditors related to the debtor);

- All existing proceedings against the debtor company will be suspended;

- The debtor will be subject to some interim measures, such as the intervention of the observer; the prohibition to transfer or constitute a lien over its properties or assets (other than those sales or transfers necessary for a normal operation); the prohibition to amend its bylaws, to grant or revoke power of attorney and to register any transfer of shares without the authorisation of the observer;

- The date of the termination of the Financial Insolvency Protection;

- The order for the debtor company to publish and present to the court a proposal of Judicial Reorganisation Agreement;

- The date, place and time of the Creditors' Meeting called to vote on the proposal of Judicial Reorganisation Agreement; and

- The call to all creditors to submit, within 15 days of the notification of the Reorganisation Resolution, the power of attorney of their representatives to vote on the Judicial Reorganisation Agreement.

After the Reorganisation Resolution has been issued, the debtor, with the assistance of the observer, must present its proposal for the Judicial Reorganisation Agreement, which is then subject to analysis in the Creditors' Meeting.

In parallel, within the eight days following the notification of the Reorganisation Resolution, all the creditors of the debtor company must request the court to consider their claims in the proceedings, submitting the documentation proving the existence of their credits ("Verificación de Créditos").

Any interested party might object to the existence of the creditors' claims, and the observer will issue a list of all credits accepted. Only creditors included in the observer's list of credits accepted will be able to vote for the Agreement.

Once the Agreement proposal has been notified, the debtor company may not withdraw it without the support of creditors representing 75% of the total amount owed.

The assignees of credits that are assigned less than 30 days prior to the commencement of the Reorganisation Procedure will not be able to vote on the proposal.
Creditors’ Meeting

The Creditors’ Meeting takes place on the day the Financial Insolvency Protection period expires. The observer must issue a report that addresses the feasibility and legality of the debtor’s proposal, as well as the percentage of the claims that may be expected to be recovered by the creditors.

The Creditors’ Meeting decides on the proposal of Judicial Reorganisation Agreement presented by the debtor. The quorum to approve it is two-thirds or more of the creditors that attend the meeting, which must comprise at least two-thirds of the total amount owed by the debtor company.

Judicial Reorganisation Agreement

The Judicial Reorganisation Agreement has the purpose of establishing the terms of payment of the debts of the debtor company, and may also establish the restructuring of its assets and liabilities for this purpose. The proposal for the Judicial Reorganisation Agreement may divide creditors into classes or categories (preferred and not preferred categories), and different categories may be offered different payment conditions. The payment conditions shall be the same for all creditors in the same class, except as otherwise accepted by the creditors (with special quorum).

The Judicial Reorganisation Agreement has an effect over all of the creditors of the debtor company, whether they attended the meeting that approved it or not.

The payment of claims from other companies from the same corporate group as the debtor, or other entities or individuals related to the debtor, may be postponed until all of the non-related creditors have been paid in full.

The debtor company is prevented from distributing dividends to its stakeholders prior to paying all the debts included in the Judicial Reorganisation Agreement.

Non-Judicial (Simplified) Reorganisation Procedure for Companies

Any debtor company may request court approval of a Simplified Agreement with its creditors, which does not require the intervention of a court, but only its final approval. With this request, the court issues an order to publish the Simplified Agreement in the Insolvency Bulletin (further referred to below), and the Agreement is then subject to a vote by the creditors. To obtain court approval, the debtor must present the Simplified Agreement executed by creditors whose claims should total at least three-quarters of the total amount owed by the debtor company), and a report from an observer that addresses the feasibility and legality of the Agreement, as well as the percentage of the claims that may be expected to be recovered by the creditors. If the Agreement is approved, it will be binding on all the creditors of the debtor.

Liquidation Procedure

The liquidation of a company may commence upon the request of the debtor itself (Voluntary Liquidation), or of one or more of its creditors (Forced Liquidation).

Voluntary Liquidation

The debtor must present to the court the following documents, among others:

- list of its assets and properties, their location, and the liens that may affect them;
• list of the assets legally excluded from liquidation;
• list of pending court proceedings;
• debt situation, identifying its creditors and the priority of the claims;
• list of all its employees, indicating their function and social security situation; and
• last balance sheet.

The corresponding court will review the debtor’s request, designate a liquidator and issue the Liquidation Resolution.

**Forced Liquidation**

Any creditor may request the liquidation of a debtor company in any of the following situations:

• when the debtor has ceased to comply with an obligation that is evidenced in an executive document (a type of document indicated in the law that evidences a debt, with respect to which a judicial trial is not required for its recognition);
• when the debtor has defaulted under two or more executive documents, evidencing different obligations; two or more enforcing processes have already been initiated with respect to such documents; and the debtor has not presented sufficient assets to cover its debts;
• when the debtor or its representatives have fled the country or gone into hiding, leaving their offices or place of business closed with no one either appointed to manage the business so that the debtor can meet its obligations, or invested with sufficient power to answer new lawsuits.

The request of Forced Liquidation shall specify the motives for the liquidation, include a bank warranty for the equivalent of UTM 100, designate an observer and provide the name of the proposed liquidator.

Upon the preceding presentation, the court will summon the parties to an initial hearing on the fifth day following the notification to the debtor. At that hearing, the debtor shall inform the court with respect to its three creditors with the largest claims. Also, at that hearing the debtor may take any of the following actions:

• provide funds sufficient to cover the claimed debts;
• accept the liquidation request;
• file for the Judicial Reorganisation Procedure (referred to above); or
• legally challenge the validity and legality of the liquidation request.

If the debtor decides to challenge the liquidation request, this will result in a formal trial to determine whether there is a legal basis for the liquidation.
Effects of the Liquidation Resolution

When the request of liquidation has been accepted by the debtor, or when the process of opposition to the liquidation has finished, if that is the case, the court shall issue a Liquidation Resolution, which will address the following matters among others:

- the appointment of a liquidator (subject to confirmation by the creditors);
- the order for courier companies to deliver all the correspondence of the debtor to the liquidator;
- the order to accumulate with the liquidation procedure all the pending judicial proceedings against the debtor;
- the public notice to prevent making payments or delivering goods directly to the debtor, and the order to provide the liquidator with all the corresponding assets and documents of the debtor;
- the order to inform all the domestic creditors of the liquidation, and that they have 30 days to request the approval of their credits against the debtor and to notify all non-domestic creditors; and
- the summoning to the first meeting of creditors, at a specified date and time.

The Liquidation Resolution has the following consequences:

- the debtor is prevented from administering its current assets (i.e. the ones subject to liquidation), which will be administered by the liquidator. All the acts or agreements of the debtor over its assets after the liquidation resolution will be null and void;
- all creditors’ rights are fixed at the time of the liquidation declaration. To this effect, debts that have not yet matured will be deemed to have matured upon the declaration of the liquidation (“acceleration of claims”);
- any debts of the debtor that were not legally set off against a debt of one of its creditors prior to the declaration of liquidation will be prevented from being set off after the declaration;
- all pending civil procedures against the debtor will be accumulated with the liquidation procedure; all future procedures against the debtor must be presented before the court that is processing the liquidation; and
- all injunctions and preservation measures against the debtor’s property are lifted and all enforcement actions suspended, except those arising out of secured claims.

The Liquidator

Upon accepting the appointment in the liquidation, the liquidator shall perform the following acts:

- take all the necessary measures to conserve the property or assets of the debtor that are considered at risk; and
- take control of the debtor’s property, company seals, accounting records, documents and other such materials, and elaborate the corresponding inventory.
**Determination of the Total Debt**

All creditors are required to file evidence of their claims and priorities before the court within 30 days of the liquidation resolution, so that they may be examined by the liquidator and the other creditors. If the claim is not objected to within 10 days, the claim is recognised and the creditor is entitled to attend and vote at the creditors’ meetings.

Creditors may also file the claims after the aforementioned period, but they are entitled to receive their proportion of the debt only with respect to future payments by the liquidator (not with respect to past payments).

**Creditors’ Meeting**

The minimum quorum to hold the meeting of creditors is the attendance of one or more creditors representing 25% or more of the total debts of the debtor. The first meeting takes place on the 32nd day after the publication of the liquidation resolution in the Insolvency Bulletin. In that meeting, the liquidator will present the financial situation of the debtor in detail, and the creditors will confirm the appointment of the liquidator.

**Liquidation Form and Deadline**

In certain cases where the debtor is a small business or the value of its assets is relatively small, the liquidation is performed in a simplified procedure which must not last longer than four months from the first meeting of creditors. The Superintendence may apply sanctions to the respective liquidator if the deadline mentioned is not met. The term to liquidate the assets in all other cases is decided by the meeting of creditors, and may in no case exceed four months for personal property, and seven months for real property, from the first meeting of creditors.

The real and personal property must be sold at public auction. The sale of securities that are publicly traded in a stock market must be auctioned in that market. A group of assets of the debtor can also be sold as an “Economic Unit”, if so agreed by the creditors’ meeting, which will also decide on the assets to be considered as part of the Economic Unit and conditions of the sale. The sale of an Economic Unit does not qualify as the sale of an ongoing business. Creditors which represent at least two-thirds of the total debts of the debtor may also decide to sell the complete business of the debtor as a whole.

**Continuation of Economic Activities**

During the process of liquidation and with the approval of the court, the liquidator, prior to the first meeting of creditors and until the day of the meeting, may continue with the activities of the debtor with the purpose of increasing the expected recovery of the creditors, enforcing pending obligations in favour of the debtor, or enabling a possible selling of assets of the debtor as an Economic Unit. This is known as provisional continuation.

Creditors representing the majority of the total debts of the debtor may also agree that the economic activities of the debtor will be continued. This continuing administration will be performed by the liquidator or other administrator (as decided by the creditors) and may not last longer than a year, which may be extended once for one additional year. This is known as a definite continuation. Once the definitive continuation has been agreed upon by the creditors, only two-thirds of the creditors may terminate the continuation of the economic activities of the debtor.
**Payment of Credits**

Credits shall be paid in the order and with the preferences and privileges contemplated at the Civil Code and the subordinations agreed by the creditors, maintaining the *par conditio creditorum* (also known as the *pari passu*) principle.

The liquidator shall propose to proceed with payments when there are enough funds available to pay at least 5% of all recognised credits, after the retention of funds sufficient to pay all costs of the liquidation procedure and making the retentions needed to pay the creditors domiciled abroad which have had no time to verify their credits.

**Termination of Liquidation**

The liquidator submits a final account of the liquidation to the court after the earliest of the following events: the deadline for liquidation is met, all the claims have been paid, or there are no more assets to liquidate. Once this final account is approved by the court, and such approval is published in the Insolvency Bulletin, the debtor recovers the administration over its assets, and all the unpaid debts of the debtor existing prior to the commencement of the liquidation procedure are deemed legally cancelled.

The liquidation procedure may also terminate if a Judicial Reorganisation Procedure is agreed upon by the debtor and two-thirds of the creditors which attend the corresponding meeting, and which represent at least three-quarters of the total debt.

**Insolvency Procedures for Individuals**

**Renegotiation Procedure for Individuals**

The new Law No. 20,720 establishes a new Renegotiation Procedure for Individuals, which is a simple procedure to facilitate an agreement between the individual debtor and his creditors, in order to avoid liquidation. This procedure is commenced by the individual by filing a request to the Superintendence, enclosing all the corresponding information regarding his assets, income, creditors, and debts, as well as a renegotiation proposal. Once the Superintendence declares the admission of the request, all the creditors of the debtor are prevented from requesting a liquidation; all the contracts entered into by the debtor remain in force, with the same payment conditions as before; statutes of limitations are suspended; and interest on debts stops accruing.

This procedure is administered by the Superintendence, which shall summon the meeting of creditors and mediate in order to obtain a renegotiation agreement. If an agreement is not achieved, the debtor and creditors may agree upon a sale procedure for the assets of the debtor. If neither a Renegotiation Agreement ("*Acuerdo de Renegociación*") nor a Sale Agreement ("*Acuerdo de Ejecución*") is possible, all the records shall be submitted to the corresponding court, in order for a liquidation procedure to be initiated.

**Liquidation of the Assets of the Individual Debtor**

The liquidation procedure for an individual debtor may be commenced by the request of the debtor himself. Alternatively, it may be commenced by the request of one or more creditors, in the event that the debtor has defaulted under two or more executive documents evidencing different obligations, two or more enforcing processes have already been initiated with respect to such documents, and the debtor has not presented sufficient assets to cover its debts. The liquidation will be administered by a liquidator in a procedure similar to that indicated for companies, with some differences indicated in the law.
Revocation of Past Actions by the Debtor that Damage Creditors

Certain actions taken by the debtor during the year prior to the commencement of a renegotiation or liquidation procedure, may be revoked by its creditors, the observer or the liquidator, as they may have damaged the *par conditio creditorum* of the creditors to recover their claims. These actions include the following:

- payments in advance;
- payments made in a manner different from that established in the corresponding agreement;
- mortgages or collateral over the debtor’s assets, granted to secure past debts;
- payments made without valuable consideration, and payments to a related company, within two years prior to the commencement of the insolvency procedure;
- in general, agreements with third parties who knew of the financial difficulties of the debtor, and that caused damage to the creditors’ position to recover their claims, within two years prior to the commencement of the insolvency procedure; and
- amendment to the debtor company’s bylaws, which reduces the debtor’s net worth, within six months prior to the commencement of the insolvency procedure.

The statute of limitations to request the revocation of the referred actions is one year from the commencement of the reorganisation or the liquidation procedure.

Transnational Insolvency

Law No. 20,270 includes a complete chapter to create efficient mechanisms to resolve cases of transnational insolvency, based on:

- cooperation between Chilean courts and other administrative agencies involved with insolvency issues and foreign states also involved in transnational insolvency cases;
- safety for commerce and investment;
- just and efficient administration of transnational insolvency and protection of the interests of national and foreign persons involved;
- protection of the debtor’s assets; and
- facilitation of the reorganisation of legal entities under financial duress to protect the invested capital and preserve employment.

This chapter applies in the following cases:

- a foreign court or a foreign representative requiring assistance from a Chilean court or other administrative entity involved;
- assistance to another state is requested regarding an insolvency procedure carried on in accordance with Chilean law;
- a single debtor is subject to Chilean insolvency procedure and a foreign insolvency procedure at the same time; and
foreign creditors or other foreign interested persons want to initiate or be part of a pending insolvency procedure under Chilean law.

Recognition of Foreign Procedures

The representative of a foreign procedure may request the recognition of the procedure from the competent Chilean court. The documentation to be presented to the court shall be duly legalised.

If the foreign procedure fulfils all requirements set forth in Law No. 20,270 and does not affect Chilean public policy, it should be recognised by the Chilean court.

From the time the recognition is requested, the foreign representative shall keep the Chilean court informed of any outstanding developments regarding the foreign procedure and any new foreign procedures initiated against the same debtor. Also, from the moment the recognition is requested, the foreign representative may request, and the Chilean court may grant, some preventive measures to secure the debtor's assets in Chile.

The recognition by the Chilean court of a principal foreign procedure suspends all new or pending procedures against the debtor and also suspends the right of the debtor to transfer or encumber its assets in Chile.

After the recognition of a foreign procedure, principal or not, the Chilean court, as per a request of the foreign representative, may order other preventive measures, including granting the foreign representative or a third party designated by the court the ability to distribute the debtor's assets in Chile, keeping enough assets to ensure the interest of the Chilean creditors.

The recognition of the foreign procedure also grants the foreign representative the right to request the revocation of past actions of the debtor in the same manner as cases explained for the regular insolvency procedures in Chile.

Parallel Procedures

Specific rules are included in the case of parallel procedures. These rules depend on whether the Chilean insolvency procedure is initiated after the recognition of the foreign procedure, the foreign procedure recognition is requested with respect to a debtor already under a Chilean insolvency procedure, or several foreign procedure recognitions are requested with respect to the same debtor.

Insolvency Bulletin

All the relevant court and Superintendence resolutions with respect to reorganisation and liquidation procedures are to be published in a new web platform called the “Insolvency Bulletin” (“Boletín Concursal”), which will be publicly available, free and administered by the Superintendence.

Conclusion

During 2014, a profound and complete change in the regulation of insolvency in Chile was made. The legal system regarding bankruptcy, applied in Chile for decades, was terminated, and a new system of reorganisation and liquidation came into force with Law No. 20,720, replacing entirely the former regulations. The main purposes of this change was to simplify and shorten the proceedings, and to improve the reorganisation process for companies in order to avoid their liquidation. It is still too soon to give an informed opinion on the virtues or defects of this new reorganisation and liquidation system.
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China

Overview and Introduction


The new bankruptcy regime is a major milestone for China. For the first time in its history, China has a unified and comprehensive bankruptcy system covering all types of enterprises, including foreign investment vehicles and state-owned enterprises.

Similar to many jurisdictions, the new bankruptcy regime introduced key concepts such as:

• voluntary and involuntary bankruptcy;
• an independent administrator;
• involvement of creditors in the administration of the bankruptcy;
• restructuring and settlement;
• extraterritoriality, allowing property outside China and certain foreign proceedings to fall within the regime;
• voidable transactions; and
• ratable distribution.

A significant feature of the new legislation relates to the protection of workers’ rights. The new regime ranks employees ahead of other unsecured creditors but behind secured creditors, who retain their priority over secured assets.

Applicable Legislation

The Bankruptcy Law, which consists of 136 articles organized into 12 chapters, applies to all types of insolvent enterprises, whether state-owned or privately owned, and includes foreign investment enterprises and financial institutions. It does not apply to individual natural persons.

The new legislation only applies to PRC entities, although it extends beyond China’s borders in relation to a debtor’s overseas properties. The new regime also recognises certain foreign proceedings that seek to secure assets located in China.

Personal Bankruptcy

There has been no law passed governing individual bankruptcy in China.

Corporate Restructuring and Insolvency

Court-Based Insolvencies

Grounds for Bankruptcy

The new regime introduces an insolvency test as a ground for bankruptcy. An enterprise will qualify for bankruptcy, restructuring or settlement under the Bankruptcy Law if the enterprise...
is not able to meet its obligations to repay its debts and its assets are less than its liabilities or it is obviously incapable of paying off its debts.

**Application to Court**

Bankruptcy proceedings are commenced in the People’s Court where the enterprise is domiciled and can be initiated by either the debtor or its creditors. If the debtor is a financial institution, the court application shall be filed by the relevant regulatory authorities under the State Council.

**Appointment of an Administrator**

Upon acceptance of the bankruptcy application, the court appoints a bankruptcy administrator who may be a member of recognised legal, accounting or specialist bankruptcy firms, or possess relevant professional expertise and qualifications. The mode of selecting an administrator and his remuneration is determined by the Supreme People’s Court.

The administrator reports to the People’s Court and is supervised by the creditors’ meeting and the creditors’ committee. The creditors’ meeting has the ability to replace the administrator or to seek his removal should he fail in performing his duties in a lawful and impartial manner, or if the creditors’ meeting deems there are circumstances that prevent him from performing his duties competently.

The administrator’s powers and duties include:

- taking control of the debtor’s property, company seals, accounting records, documents and other related materials;
- investigating and reporting on the debtor’s financial status;
- making decisions in relation to the debtor’s internal management and daily expenditure;
- deciding whether to continue or suspend the debtor’s business operations prior to the first creditors’ meeting;
- managing and disposing of the debtor’s property;
- representing the debtor in litigation, arbitration or other proceedings;
- proposing the holding of creditors’ meetings; and
- performing other functions that may be required by the court.

An administrator who fails to act with due diligence and care and to faithfully perform his duties could face a fine or personal liability if found to have caused loss to a creditor, the debtor or a third party.

**Creditors’ Claims**

Creditors are required to file their claims within a time period stipulated by the People’s Court. Such period commences from the date of publication by the People’s Court of the announcement of its acceptance of the bankruptcy petition and runs for a minimum of 30 days and a maximum of three months.
Major eligible claims include:

- debts that exist at the time of the court’s acceptance of the application for bankruptcy;
- unmatured debts;
- conditional debts or debts subject to time limits;
- claims pending litigation or arbitration;
- debts owed to joint creditors;
- indemnity obligations owed to a guarantor of the debtor or to another joint debtor who has discharged a debt on behalf of the debtor; and
- damages under a contract terminated by the administrator or the debtor under the provisions of the Bankruptcy Law.

**Creditors’ Meetings**

Creditors may participate in the bankruptcy process through creditors’ meetings and the creditors’ committee.

A creditor who has submitted a claim in the bankruptcy is entitled to attend and vote at the creditors’ meeting (save for secured creditors who cannot vote on the adoption of a settlement plan or distribution plan of the debtor’s assets unless they have waived their right to priority). However, a creditor whose claim has not been determined may not exercise voting rights except where the People’s Court has provisionally determined the amount of the claim for the purpose of allowing the creditor to vote. Generally, a resolution of the creditors’ meeting is passed by a simple majority of the creditors with voting rights present at the meeting and a majority representing 50% or more of the value of the debtor’s unsecured debt.

The creditors’ meeting may:

- verify creditors’ claims;
- apply with the court to replace or remove the administrator;
- supervise the administrator;
- select members of the creditors’ committee;
- determine whether to continue or suspend the debtor’s business operations;
- approve restructuring plans and settlement agreements;
- approve plans to manage, realize and distribute the debtor’s property; or
- perform other functions that the court requires.

**Creditors’ Committee**

The creditors’ meeting may establish a creditors’ committee that comprises creditor representatives elected by the creditors’ meeting. The composition of the creditors’ committee, which totals not more than nine people and must include a representative of the debtor’s employees or a representative of its trade union, is subject to the approval of the
People’s Court in writing. The creditors’ committee is responsible for supervising the management, disposal and distribution of the debtor’s property, proposing the convening of creditors’ meetings and such other duties as may be delegated by the creditors’ meeting.

**Creditors’ Right to Set-Off**

Creditors who incurred debts to the debtor prior to the court’s acceptance of the bankruptcy application may request the administrator to set off their debts against their claims. However, set-off is not permitted if the creditor incurred the debt with knowledge of the debtor’s inability to repay its debts unless the debt was incurred more than one year prior to the application for bankruptcy or is due by operation of law.

**Counterparties to Contracts**

Contracts entered into before the acceptance of the bankruptcy application but not yet fully performed can be terminated or continued by the administrator. The administrator is required to notify the counterparty of his decision within two months of the acceptance of the bankruptcy application or 30 days after receiving a reminder from the counterparty. Failure to do so deems the contract to be terminated. If the administrator decides to continue a contract, the counterparty is entitled to request the administrator to provide a guarantee. A failure to provide the guarantee also deems the contract to be terminated. If a contract is terminated in accordance with the legislation, the counterparty may file its claim on the basis of its right to claim damages as a result of the termination.

**Priority and Ranking of Debts**

The Bankruptcy Law sets out a hierarchy of debts to determine priority of payment, which must be made in the following order:

- bankruptcy expenses;
- common interest debts (i.e. certain debts incurred after the court accepts the bankruptcy petition);
- employee claims, including unpaid salaries, medical and disability subsidies, basic old-age and medical insurance premiums, and compensation in accordance with PRC law;
- social insurance premiums and outstanding tax; and
- common (unsecured) claims in bankruptcy.

If the property in bankruptcy is insufficient to satisfy the discharge requirements of a certain rank of debts, the distribution to such rank shall be effected on a pro rata basis.

Secured creditors generally have priority to the extent of the value of their secured properties while any shortfall is to be treated as an unsecured claim. However, employee claims accrued prior to the promulgation of the Bankruptcy Law on 27 August 2006 will continue to enjoy their right (under the previous law) to priority over secured creditors.

**Restructuring and Settlement**

An important feature of the new regime is the availability of rescue options within the formal process to restructure or rehabilitate viable businesses. Although the court may have accepted a bankruptcy application, the Bankruptcy Law allows a debtor or its creditors the opportunity prior to an enterprise being declared bankrupt to apply with the court for
restructuring or reorganisation of its business. The legislation also allows a debtor to apply for a compromise or settlement of its debts with its creditors.

**Restructuring Procedure**

Prior to the enterprise being declared bankrupt, the debtor or its creditors can apply to the People’s Court for restructuring. The debtor or administrator must submit a draft restructuring plan to the court and the creditors’ meeting within six months (with an extension of three months if approved by the court) of the court’s ruling for restructuring. During the restructuring period, the debtor can apply for court approval to continue to manage its properties and business under the administrator’s supervision.

Creditors are classified into the following voting groups:

- creditors with secured claims over specific properties of the debtor;
- employees with claims on salaries, medical and disability subsidies, basic old-age and medical insurance premiums, and compensation payable into the individual accounts of employees in accordance with PRC law;
- claims on outstanding taxes, and
- common (unsecured) claims.

Upon receipt of the draft restructuring plan, the court convenes a creditors’ meeting within 30 days to vote on the draft plan. The draft plan must be approved by a majority of the number of creditors in each voting group, and the amount of claims they represent must account for at least two-thirds of the total amount of claims in that group. If the draft restructuring plan is not approved by all of the voting groups, the debtor or the administrator can still apply to the court for approval if certain conditions are satisfied. If the restructuring plan is not approved, the court terminates the restructuring and declares the debtor bankrupt.

The debtor is responsible for the implementation of the restructuring plan. A supervision period is imposed by the court, during which time the administrator is required to supervise the implementation process and the debtor must report to the administrator. If the debtor is unable or fails to implement the restructuring plan, the court terminates the restructuring plan and declares the debtor bankrupt upon petition from the administrator or a materially interested party.

During the restructuring period, the court has additional powers to terminate the restructuring plan and declare the debtor bankrupt if:

- the debtor’s business operation or financial status continues to deteriorate and cannot be salvaged;
- the debtor has acted fraudulently, diminishes its assets in bad faith or has acted in a way that is adverse to the creditors; or
- the administrator is unable to perform his duties and functions as a result of the debtor’s actions.

Secured creditors’ rights over pledged assets are suspended during the restructuring period. If there is a risk of damage to the secured asset or of significant diminution in its value such that the secured creditors’ rights are prejudiced, the secured creditor may apply with the People’s Court to enforce its rights. Once the restructuring plan is approved by the court, it is binding on the debtor and all of the creditors.
Settlement Procedure

Settlement allows the debtor to compromise its debts directly with its creditors after the bankruptcy proceedings have commenced. It requires an application by the debtor accompanied by a draft settlement agreement. If the court approves the settlement application, it will make an announcement and convene a creditors’ meeting. Secured creditors may exercise their security rights from the date the court approves the settlement.

Once the settlement plan is approved by the creditors’ meeting and the court, the administrator is obliged to transfer the business and assets to the debtor. For the plan to become effective, it must be approved by more than half of the creditors with voting rights present at the meeting. The claims represented by such creditors must account for at least two-thirds of the total amount of unsecured claims. If the settlement plan is rejected at the creditors’ meeting or by the court, the court will declare the debtor bankrupt.

A settlement agreement that has been approved is binding upon the debtor and the creditors covered by the settlement, i.e. the creditors who held an unsecured claim against the debtor at the time the court accepted the bankruptcy petition. If the debtor is unable or fails to implement the settlement agreement, the court, upon the request of a creditor covered by the settlement, terminates the implementation of the settlement agreement and declares the debtor bankrupt.

Asset Recovery

Moratorium

A moratorium is imposed on the debtor’s assets upon acceptance of the bankruptcy application by the court. Upon acceptance of the bankruptcy application, all preservation measures against the debtor’s property are lifted and all enforcement actions are suspended. Civil actions or arbitration procedures that have commenced against the debtor but not completed are stayed. Any repayment of debts to a creditor during this period is deemed invalid.

Collection and Realization of Assets

The debtor is obliged to deliver up its property to the administrator after the court accepts the bankruptcy application. The administrator has a duty to get all the property of the debtor and to prepare asset realisation and distribution plans that are submitted at the creditors’ meeting for approval. Unless resolved otherwise at the creditors’ meeting, the administrator is obliged to dispose of the debtor’s property in the bankruptcy by way of auction. Property that cannot be auctioned off or whose transfer is restricted by state regulations shall be disposed of by those state regulations.

Voidable Transactions

The administrator has the power to investigate and claw back questionable transactions.

The administrator is able to petition the People’s Court to revoke transactions entered into within one year preceding the court’s acceptance of the bankruptcy application as follows:

• transfers of property for no consideration;
• transactions carried out at markedly unreasonable prices;
• provision of security for unsecured debts;
• premature settlement of undue debts; and
• renouncement of creditors’ claims.

Likewise, the administrator can recover debts that have been repaid to individual creditors within the six months prior to the acceptance of the bankruptcy petition, except where the debtor has benefited from such a repayment.

Any transactions that conceal or transfer assets for the purpose of avoiding liabilities, or which fabricate debts or acknowledge a fictitious debt, are deemed invalid by the Bankruptcy Law.

Recovery from Directors and Officers

The administrator is able to recover any irregular income or assets misappropriated from the debtor by its directors, supervisors or senior management using their authority. Directors and officers may also face civil liability if breach of their duties of honesty and diligence resulted in the debtor’s bankruptcy. After bankruptcy proceedings are finished, if they are found to be liable, they will be disqualified from being an office-holder of any enterprise for three years.

Cross-Border Insolvency

Bankruptcy proceedings commenced in the PRC pursuant to the Bankruptcy Law cover not only the debtor’s assets in the PRC but also extend to its overseas assets. The new legislation also recognises foreign bankruptcy proceedings involving assets in the PRC so as to allow execution in the PRC, provided:

• there are relevant reciprocal treaties between the PRC and the foreign country;
• the foreign bankruptcy proceedings do not contravene the laws, sovereignty, security, or social and public interests of the PRC; and
• the legal interests of creditors in the PRC are not prejudiced.

Out-of-Court Mechanisms

Although the new legislation lays down a framework for restructuring and settlement within the formal bankruptcy process, it is possible for entities to adopt informal measures not involving the court. Informal work-outs or similar options may be an alternative to those parties seeking greater control of the restructuring process and not wishing to be restricted by the requirements under the new legislation.

In the past, when business enterprises were largely state-owned, the rehabilitation of ailing businesses was a process directed by the state. As businesses evolved to include private and foreign interests, the restructuring of an enterprise would have required the approval of, and coordination between, the relevant stakeholders.

Accordingly, as in other jurisdictions, the success of an informal rescue plan in China vastly depends upon the agreement and cooperation between the various factions that, in the case of China, may involve state interests.

Conclusions and Additional Observations

China’s bankruptcy legislation encapsulates many concepts familiar to other jurisdictions.

While the current framework of the Bankruptcy Law requires refinement, the law is considered to be a major development for China and provides investors with a unified and comprehensive insolvency regime.
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Colombia

Overview and Introduction

On 27 December 2006, the Colombian Congress enacted a complete insolvency regime for companies (Law No. 1116 of 2006 (“Law No. 1116”), which came into force on 28 June 2007. The insolvency regime governs domestic reorganisation and liquidation proceedings and also includes a chapter that provides coordination mechanisms within transnational insolvency proceedings.

The Colombian insolvency regime, applicable to companies and business groups, has two major objectives: on one side, the regulation of the proceedings that ensure creditors’ protection; and on the other, monitoring and making it possible to recover and preserve companies that are still viable. The regime is based on principles aiming to guarantee that the proceedings will cover all of the debtors’ assets. These principles are also oriented to ensure equality between debtors and creditors and the respect of fundamental rights. The insolvency regime enables debtors to enter into a long-term personalised payment agreement with their creditors, giving the company a chance to recover and pursue its activity.

The first amendment to Law No. 1116 was made by Law No. 1429, enacted on 29 December 2010. Law No. 1429 introduced changes to Law No. 1116 that aimed to make insolvency proceedings more agile and flexible, for example, by reducing the eligibility requirements for these proceedings, and by admitting only documentary evidence to challenge the inventory of the credits.

Since May 2011, the Colombian insolvency regime has included, through the Decree 1749 of 2011, provisions regarding the insolvency of business groups. These provisions are oriented to the transparency and coordination of insolvency proceedings involving two or more companies of the same business group. According to this decree, a business group is an integrated set of individuals, companies, trusts, or entities of any other nature that are involved in economic activities, linked or related to each other by the fact of being controlled or subordinated, or because most of their equity is owned or under the administration of the same individual or legal entity.

On 1 January 2016, the new General Procedural Code was enacted. This regulation includes a set of provisions governing insolvency proceedings for individuals not devoted to commercial activities.

Law No. 1676, enacted in 2013 (Law of secured movable assets – Ley de garantías mobiliarias), introduced some modifications to Law No. 1116. According to this law, creditors who constituted guarantees (i.e. security interests) over the debtor’s moveable assets can enforce the guarantees to obtain payment of the debt, even if the debtor is admitted into reorganisation. However, the possibility of enforcing these guarantees applies only to the assets that are not necessary for the development of the economic activity of the debtor. If the debtor enters into liquidation proceedings, and the guarantees over the debtor’s assets are registered, the guaranteed goods can be excluded from the group of liquidated assets in order to pay the debt, as long as there are no outstanding labour credits.

The above-mentioned is an exception to the rule established in Law No. 1116, according to which it is not permitted to start a collection proceeding against the debtor once the reorganisation proceeding starts or to pay the debt with an asset from the debtor unless the asset is awarded as a consequence of a liquidation proceeding.
The creditors that hold movable guarantees over the debtor’s assets rank in the second class of credits (see “Creditor Ranking” below).

Applicable Legislation

Companies’ insolvency regime is regulated by Law No. 1116, modified by Law No. 1429. Insolvency of business groups is regulated by Decree 1749 of 2011. However, these special regimes are supported by other general regulations. Some of the most important provisions regarding these matters are the Colombian Code of Commerce, and Law Nos. 222 of 1995 and No. 550 of 1999, which contain provisions applicable to the insolvency regime.

Individuals who are not engaged in commercial activities have an independent regime. The General Procedural Code provides the proceeding to be followed in this case. The structure of this proceeding is similar to the one provided for companies.

Insolvency Regime for Individuals Not Engaged in Commercial Activities

According to article 538 of the General Code of Procedure, any individual who is not engaged in commercial activities and is involved in a payment suspension situation (understood in Colombian legislation as a person’s inability to pay two or more creditors for more than 90 days or when acting as a defendant in one or more collection proceedings) is entitled to request the commencement of an insolvency proceeding according to the provisions established in this code.

These insolvency proceedings, meaning the debt negotiation and validation of agreements, have to be carried out before a Conciliator member of any Conciliation Centre of the domicile of the debtor, duly authorised by the Ministry of Justice (Ministerio de Justicia), including Public Notaries. If any controversy within the proceedings is out of the scope of the competence of the Conciliator, the proceedings are to be carried before the Civil Municipal Court of the domicile of the debtor. This court is also competent whenever the payment agreement reached within the insolvency proceedings is challenged and during the liquidation process.

Request for the Negotiation of the Debt

According to article 539 of the General Code of Procedure, the insolvency proceeding starts with the debtor filing a request for the negotiation of the debt. In this request, the debtor explains the circumstances that led to the payment suspension situation and includes a proposal for the negotiation of the debts. The proposal has to be clear, objective and consistent with the debtor’s current economic situation and credit record. The request for the negotiation of the debt includes, among other things, the following information:

- A complete list of all the creditors, presented in the order provided by the Civil Code, the nature and amount of each debt, the date on which the debt was incurred and the documents in which it is supported;

- A complete list of all the assets, including those that are located in foreign countries, indicating if there are any encumbrances or seizure measures over the assets;

- A complete list of all pending judicial and administrative procedures in which the debtor is involved;

- A certificate given by the debtor’s employer with information about the incomes or, if the debtor is an independent worker, a declaration containing this information; and
• The amount of resources available for the payment of the obligations, discounting expenses necessary for the subsistence of the debtor and of persons depending on him, if any.

Negotiation of the Debt

Once the request is accepted, the Conciliator in charge starts the negotiation of the debt. The proceedings for the negotiation of the debt take place within a 60-day period starting on the date of the acceptance of the request. This term can be extended for 30 additional days upon request from the debtor or from any of the creditors included in the final list of credits.

The negotiation of the debt takes place at a hearing scheduled within 20 days after the acceptance of the request. During this hearing, the Conciliator indicates the amount of each debt and the value of the assets as reported by the debtor. At this point, the creditors are allowed to request clarifications regarding their own credit or regarding any other credit submitted for approval, and are entitled to file objections. If no objections are filed, the credits and assets detailed by the Conciliator at the beginning of the hearing are considered as definitive and the negotiation to consider and accept the payment proposal filed by the debtor with the request is formally opened.

If objections are filed, the Conciliator seeks to reach an agreement between the debtor and its creditors and is entitled to request the submission of evidence in order to resolve the objections and differences between the parties. If no agreement is reached, the Conciliator will declare the conciliation failed and will send the evidence and written objections to the competent judge.

If an agreement is reached, it is subject to the following rules:

• It has to be formalised within 60 or 90 days following the date in which the request was accepted;
• It has to be approved by two or more creditors representing at least 50% of the total value of the debt and must be expressly accepted by the debtor;
• It must include all the creditors prior to the acceptance of the request;
• It must respect the creditor priority rules established by Colombian laws;
• If the agreement involves legal acts affecting property subject to registration, a copy of the agreement shall be registered before the competent authority;
• In any case, the payment agreement will become a novation of the obligations unless there is an agreement between the debtor and each creditor involved in the proceeding; and
• The credits must be paid within five years from the date the agreement was subscribed.

Once the agreement has been approved, it can be modified upon request of the debtor or of the creditors that represent at least one-fourth of the value of the unpaid debts.

The approval of the payment agreement suspends all collection proceedings against the debtor. These proceedings will remain suspended until the total fulfilment or failure of the agreement is verified. The agreement constitutes a collection title, i.e. a document containing a clear, express and enforceable obligation. Ordinarily, a creditor may initiate collection proceedings in order to obtain the fulfilment of the obligation contained in a collection title.
However, a payment agreement will not be enforceable, and creditors will not be permitted to file a collection proceeding, until the Conciliator officially declares the breach of the agreement.

When the undertakings contained in the agreement are not fulfilled, the debtor or any of the creditors are entitled to request the scheduling of a new hearing to discuss possible modifications to the agreement. If no modifications are agreed, or if the debtor does not comply with the new undertakings as agreed, the Conciliator will declare the failure of the agreement. As a consequence, the pending judicial collection proceedings against the debtor that were suspended will be resumed.

Among the most important provisions introduced by the General Procedural Code are those that provide for the recognition of private agreements and the liquidation of existing assets. The recognition of private agreements, governed by article 562 of the above-mentioned code, allows individuals not devoted to commercial activities to structure a payment agreement with two or more creditors that represent at least 60% of the total debt and to present the agreement before an authority to be recognized as valid. This private agreement has the same beneficial effects as a payment agreement negotiated before a Conciliator.

If these negotiation tools fail, or if the commitments adopted therein are not fulfilled by the debtor, it is possible to file for a liquidation proceeding before Civil Courts. This proceeding is also regulated by the General Procedural Code and its purpose is to reach an agreement to liquidate available assets and pay the pending obligations. If no agreement is reached, the judge will hold a hearing to adjudicate assets to pay the existing debts. This is the last step of the insolvency proceeding for individuals not devoted to commercial activities.

Companies’ Insolvency Regime

Law No. 1116 of 2006

This provision regulates both reorganisation and liquidation proceedings for individuals, companies and institutions dedicated exclusively to commercial activities in Colombia.

Acknowledged Entities

Law No. 1116 regulates reorganisation and liquidation proceedings regarding the following persons:

- Commerce-involved individuals and companies;
- Mixed economy companies;
- Branches of any foreign company;
- Trust assets regulated by national laws and focused on business; and
- Other entities covered by the provisions of Law No. 1116.

Some excluded entities are:

- Stock market entities;
- Entities supervised by the financial regulator;
- Public service entities; and
Territorial entities and decentralised entities.

The above-mentioned entities will follow a different proceeding and will not be sheltered by the benefits and opportunities afforded by this special regime.

Competent Authorities

The competent authority may vary depending on the nature of the entity that is requesting the reorganisation or liquidation proceeding. The Superintendency of Corporations (Superintendencia de Sociedades) is, by virtue of Decree No. 2179 of 2007 and Law No. 1116, the competent authority tasked to carry out reorganisation and liquidation proceedings regarding companies, industrial economy corporations, branches of any foreign company and commerce-involved individuals. For other cases, i.e. reorganisation and liquidation of trust assets, the competent authority will be the Civil Circuit Court or as determined within special regulations.

Legal Requirements to Initiate These Proceedings

According to Law No. 1116, there are specific grounds for a debtor to request admission to an insolvency proceeding, whether as a reorganisation or as a liquidation proceeding.

However, in principle,¹ any of the above-mentioned proceedings require that the debtor is in a payment suspension situation (understood in Colombian legislation as the inability to pay two or more creditors for more than 90 days or when acting as a defendant in one or more collecting proceedings) or that, due to particular circumstances of the market or to internal difficulties of the company, it is foreseeable that the debtor will not be able to pay for the obligations it has acquired.

Reorganisation Proceeding

The reorganisation proceeding aims to preserve companies which are still financially viable through an agreement with its creditors, so that all credits are included and paid as the insolvent company recovers financially. When no agreement is accomplished or when the insolvent company does not fulfil the agreement, the liquidation process starts immediately.

The reorganisation proceeding protects the debtor from an inevitable bankruptcy situation. The reorganisation process is collective, which means that all creditors are summoned to submit their credits and participate in the decision-making process. An automatic stay applies. Creditors will not be entitled to carry out collection proceedings against the debtor to collect the debts that were incurred prior to the beginning of the reorganisation proceeding, as these debts are part of the reorganisation proceeding and may only be satisfied therein.

Among the specific requirements a debtor must comply with in order to be admitted to a reorganisation proceeding is the obligation of maintaining accounting records according to the legal provisions and not having pending social security obligations.

A promoter is appointed to guide the proceeding and perform technical financial duties. The promoter, among other duties, proposes a payment agreement according to the projected cash flow of the company.

Pursuant to Law No. 1116, whenever a reorganisation agreement is approved by a plurality of creditors representing at least the absolute majority of the votes cast defined proportionally according to the value of each debt, the decision must be confirmed by the competent authority, either the Superintendency of Corporations or the civil court, during a

¹ In principle because the liquidation proceeding may begin due to the breach of the reorganisation agreement, in which case the payment suspension situation will not be required.
special hearing. The competent authority may give its approval to the reorganisation agreement or suspend the hearing and require the agreement to be amended. If the authority does not approve the agreement, it must order the dissolution of the company and the liquidation of its assets for distribution among the creditors, according to the debt priorities established by law.

Breach of the agreement on the terms confirmed by the authority, and the non-fulfilment of any social security or other administration obligation during the period the agreement is in force, will have the same consequence as the non-approval of the agreement.

Whenever the debtor or a creditor denounces the failure to comply with the reorganisation agreement or the administration obligations, the authority will set a date for a unique special hearing to apply measures to solve the situation. If this contingency is not settled within the hearing, the judge will declare the termination of the agreement and continue to a liquidation proceeding.

**Creditor Ranking**

Not all creditors are treated equally. Much like other insolvency proceedings, Colombian legislation establishes a ranking for creditors within a reorganisation or liquidation process. The Colombian Civil Code (articles 2488 to 2511) establishes the preference and order in which creditors must be paid:

- The first class to be paid corresponds to employment-related obligations and special tax-related obligations.
- The second class includes creditors who have a pledge constituted in their favour.
- Creditors who have a mortgage belong in the third class.
- Other tax-related obligations and strategic suppliers to the business belong in the fourth class.
- Finally, all other creditors who have a title such as a promissory note or contract with no guarantees are part of the fifth class and are paid last.
- Credits with related companies are subordinated and paid after the fifth class.

External creditors are paid before paying the internal debt, i.e. before returning equity to shareholders. Furthermore, if a shareholder has not paid its equity, or social liability is extended beyond such contributions (by law or by the company’s bylaws), the liquidator within a liquidation process may start a process against that shareholder to collect the owed sum in order to pay external creditors.

Some credits are legally delayed, which means they are only paid when all the others have been fulfilled. These debts include those owed to persons specially related to the debtor. The law defines “specially related” as “corporations related among them as parent companies, subsidiaries or branches, or the company and its administrators, statutory auditors and attorneys at law in some cases.” These obligations will not be delayed if they arise from new resources offered to the company after its admission into the insolvency process.

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2 These obligations refer to the expenses incurred in the reorganisation proceeding and any other obligation incurred by the debtor after the initiation of the reorganisation proceeding.
Order of the Proceedings

Request for admission. In order for a company to be admitted into a reorganisation process, it must submit all relevant financial information, including information about assets and credits, a projected cash flow to pay all pending obligations and a business reorganisation plan. Creditors may also request the admission. The request must include:

- A complete list of all the creditors, presented in the order set forth by the Civil Code, the nature and amount of each debt, the date on which the debt was incurred and the documents in which it is supported.
- A complete list of all the assets, including those that are located in foreign countries, indicating if there are any encumbrances or seizure measures over the assets.
- A complete list of all pending judicial and administrative procedures in which the debtor is involved.

Decision to admit the company. This first decision of the Superintendency of Corporations is to open the reorganisation proceeding. With this decision, the Superintendency orders the company to make the required publicity, orders the registration of the decision in the corresponding Chamber of Commerce and may order injunctive relief.

Submission of the credits. Whoever is interested may present relevant information and evidence for its credit to be taken into account within the proceeding. This is the opportunity to make sure the information related to the credit is included in the record and the credit is taken into account within the process.

The project of ranking and qualification of credits and rights to vote. With the information provided by the company, the promoter presents a project to rank and qualify the pending credits and rights to vote.

Objections. Creditors are entitled to challenge the project of ranking and qualification if they consider that it does not correctly reflect their credit or rights to vote.

Conciliation hearing. If the objections presented are not resolved by a direct arrangement between the company and the creditors, the Superintendency will summon a conciliation hearing seeking for an agreement. Finalizing this hearing, the Superintendency will adopt a final version of the ranking and qualification of credits and rights to vote and will determine the timeframe to present the reorganisation agreement.

Reorganisation agreement. The reorganisation agreement must be subscribed within the four months following the conciliation hearing. Taking into account the cash flow of the company, the promoter must present the reorganisation agreement approved by the majority of votes (50% plus one vote). The reorganisation agreement must include all pending credits as recognised in the ranking and qualification and must respect the creditor ranking and preferences. If the reorganisation agreement is not presented in time, the Superintendency will designate a liquidator.

Verification hearing. After approving the reorganisation agreement, the Superintendency will summon and carry out a hearing to receive observations and validate its legality. Annual meetings will be scheduled to review and verify the fulfilment of the agreement.

Judicial Liquidation Proceeding

This special regime refers to the proceeding by means of which the authorised judicial authority disposes of the debtor’s assets in order to transform them into money and hence,
ensure the fulfilment of the economic obligations contracted by the debtor by paying the creditors. This process of liquidating the assets may take place by direct sale or by private auction, each following specific rules oriented to protect the assets and guarantee that a higher profit is taken for the proceeding.

After the auction or sale is over, the proceeds are distributed among the creditors. In cases where it is not possible to sell all the available assets, the law provides a mechanism for the remaining assets to be distributed among the creditors, either in respect of the payment priority or via a judicial decision.

A judicial liquidation process may be initiated as a consequence of the failure of a reorganisation agreement in accordance with the terms of Law No. 1116 or whenever there is cause for an immediate judicial liquidation as stipulated by Colombian law.³

Whenever a company or individual starts a judicial liquidation proceeding, the contracts entered into by the company or individual will be automatically terminated, except those that are necessary to preserve the debtor’s assets, or as authorised by the competent authority trying the proceeding.

The liquidation proceeding will end with the final liquidation of the debtor’s assets or with a reorganisation agreement. The Colombian insolvency regime gives a last chance to the debtor and its creditors to reach a payment agreement, even if the liquidation proceeding is already in course. In fact, once the inventory of all the assets and the votes cast have been approved – prior to the commencement of the sales – the opportunity to try to reach a new reorganisation agreement can be requested.⁴ If the request is accepted, the liquidation proceeding will be suspended until an agreement is reached. If no agreement is reached, the suspension of the proceeding will be lifted and the liquidation will continue.

The liquidation proceeding concludes with the dissolution of the company. If the debtor is a commerce-involved individual whose bad faith or intent to defraud is demonstrated, the judicial authority trying the proceeding may prohibit the individual from undertaking commercial activities for up to 10 years.

Out-of-Court Mechanisms

When agreed to by the debtor, insolvency law allows a group of creditors representing more than half of the amount to be claimed in the possible reorganisation or liquidation proceeding to execute a written extrajudicial agreement that will have the same effect as a reorganisation agreement. This agreement is valid per se. However, the parties may ask the authority that would have been competent to preside over the reorganisation proceeding to initiate a validation procedure to verify that the agreement respects the following matters:

- Correct percentages required to endorse the agreement;
- Confirmation that the negotiations were held under every publicity requirement and that every creditor was notified thereof;
- Confirmation that the agreement grants the same recognition to every creditor depending on the quality of its credit;
- The exclusion of any illegal or abusive clause in the agreement; and

³ These causes may vary from the will of the stockholders of the company for external reasons, such as the decision of a competent authority.
⁴ The Colombian regime provides that the liquidator or at least 35% of the creditors voting may request a new chance to conclude a reorganisation agreement.
• Fulfilment of every legal requirement.

If the competent authority validates the extrajudicial agreement, it will have the same effect as an agreement reached within a reorganisation proceeding. Similarly, if an extrajudicial agreement that has been validated is breached, the rules applicable to a breach of an agreement reached within a reorganisation proceeding would apply.

Business Groups Insolvency Regime

Decree 1749 of 2011

This provision regulates both reorganisation and liquidation proceedings for business groups in Colombia.

Acknowledged Entities

According to Decree 1749 of 2011, a business group is an integrated set of individuals, companies, trusts, or entities of any other nature that are involved in economic activities, linked or related to each other by the fact of being controlled or subordinated, or because most of their capital is owned or under the administration of the same individual or legal entity.

Competent Authorities

The Superintendencies of Corporations and the Civil Courts are the competent authorities tasked to carry out reorganisation and liquidation proceedings regarding business groups. The Superintendency of Corporations is competent whenever any of the companies or members of the group are subject to its control.

Legal Requirements to Initiate These Proceedings

The request to initiate the reorganisation or liquidation proceedings of a business group can be filed by two or more of the group members as long as none of the petitioners are excluded from the insolvency regime according to Law No. 1116.

The request should also respect all the requirements set forth in Law No. 1116. In addition, the existence of the business group must be demonstrated.

Reorganisation Proceeding

The reorganisation proceeding may be carried out separately for each member as a debtor or jointly for all the members upon decision of the Superintendency of Corporations or upon request of any member of the group. The creditors of any of the members against which an insolvency proceeding has already started may also request for the proceeding to be carried out jointly.

The reorganisation proceeding should respect the identity of each one of the members of the group, unless a judicial liquidation proceeding is initiated with the consolidation of the assets of all the members in order to ensure the effectiveness of the proceeding. The consolidation of the assets can also be requested by the petitioner of the liquidation proceeding.

Judicial Liquidation Proceeding

The judicial liquidation proceeding of business groups follows the same rules set forth in Law No. 1116. However, as previously mentioned, there are special provisions related to business groups, such as provisions governing the consolidation of assets and regarding the
coordination of the proceedings, including coordinated and joint hearings. These provisions are contained in Decree 1749 of 2011.

Cross-Border Insolvency Proceeding

The Colombian insolvency regime provides for cooperation between Colombian authorities and foreign countries that intervene in insolvency proceedings. This cooperation is intended to protect the debtor and its creditors and to create a safe framework for foreign investment and commerce.

The provisions regarding cross-border insolvency are applicable whenever:

- A foreign court or a foreign representative\(^5\) requests the assistance of Colombia regarding a foreign insolvency proceeding;
- Foreign assistance is required regarding an insolvency proceeding carried out according to Colombian laws;
- Simultaneous proceedings in Colombia and in a foreign country are being carried out regarding a single debtor; or
- Debtors or interested third parties in a foreign country ask to intervene in an insolvency proceeding according to Colombian laws.

In case of conflict between the insolvency regime and any obligation accepted by Colombia through international treaties involving one or more foreign states, the obligation will prevail.

The liquidator within a proceeding in Colombia is authorised to act within foreign proceedings according to Colombian law, whenever there is no conflict with the laws governing the foreign proceeding.

It is very important to stress that Colombian authorities must respect Colombian public policy. As a consequence, measures adopted in foreign proceedings that are against public policy will not be adopted in Colombia.

Conclusions and Additional Observations

The insolvency regime in Colombia provides advanced methods to promote the recovery of potentially stable companies and, especially, the guarantees given to their creditors. The inclusion of strategic suppliers within the debt payment priority and the possibility for the creditor to request injunctive relief within the proceedings are some of the privileges provided by these regulations. These provisions not only represent a major development towards equality between debtors and creditors, but also afford an incentive for foreign investors seeking a fair insolvency regime that guarantees the recognition and payment of debts derived from business activities.

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\(^5\) A foreign representative is the person or the organ designated in a foreign proceeding to administer the reorganisation or liquidation of the assets or business of the debtor, or to act as a representative in a foreign proceeding.
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Czech Republic

Overview and Introduction

The Czech Insolvency Code came into force on 1 August 2008 after the previous Bankruptcy Act, dated 1991, proved itself inadequate and out of date and it was decided to adopt a completely new and complex regulation.

The Insolvency Code is based on a concept of uniform insolvency proceedings. First of all, the Insolvency Code requires the competent court to decide whether or not the debtor is actually insolvent. Where the debtor is considered insolvent, the most appropriate way of dealing with insolvency is elected – which may be a bankruptcy, reorganisation, debt clearance, or other specific means in case of certain entities or situations. Insolvency proceedings differ in each case. The Insolvency Code is a unified code which governs insolvency proceedings, regardless of whether the debtor is an individual or legal entity, an entrepreneur or not.

This Guide is intended to be a general summary of the regime applicable in respect of insolvency proceedings under the Insolvency Code.

Applicable Legislation

Insolvency proceedings in the Czech Republic are primarily regulated by Act No. 182/2006 Coll., on Insolvency, as amended (the “Insolvency Code”). Related questions which are not addressed by the Insolvency Code are governed by Act No. 99/1963 Coll., on Civil Procedure, as amended (the “Civil Procedure Code”). Additionally, Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings of the Council of the European Union is applicable in the Czech Republic. Additional laws may interact with the administration of an insolvent individual or corporations.

The Insolvency Code is applicable to debtors that are physical persons as well as to legal entities. The insolvency proceedings regime differs in some respects depending on whether the debtor is an entrepreneur or not.

Meaning of Insolvency

The insolvency proceedings described below are conducted only if the debtor is insolvent or insolvency is impending.

Insolvency

A debtor is insolvent if it is either illiquid or over-indebted.

A debtor (either an individual or a legal entity) is illiquid if it is unable to pay its debts as they fall due and:

- The debtor has more than one creditor;
- The debtor has due and payable monetary obligations which have been overdue for more than 30 calendar days; and
- The debtor is unable to satisfy such obligations (i.e. the debtor has suspended payments of a substantial portion of its monetary obligations, has defaulted with respect to payment of the same for more than three months past the due date, or is unable to satisfy certain due and payable obligations of the company by means of judicial enforcement).
A debtor who is a legal entity or a natural person conducting business activity is further insolvent in case such debtor is over-indebted. The debtor is over-indebted when:

- It has more than one creditor; and
- The sum of its obligations exceeds the value of its assets.

When determining the value of the debtor’s assets, a further management of the assets or a further operation of the debtor’s business should be taken into consideration, provided that there is a justified presumption that, in light of the circumstances of the case, the debtor would be able to continue to manage its assets or operate its business (“going-concern assumption”).

**Impending Insolvency**

Insolvency is impending on the debtor in cases where, taking into account all the circumstances of the case, it is reasonable to assume that the debtor would not be able to satisfy a substantial portion of its monetary obligations in a due and timely manner.

**Insolvency Proceedings**

Insolvency proceedings in the Czech Republic are always judicial proceedings held by a competent court (“Insolvency Court”), which makes decisions and oversees the entire procedure. The subjects participating in the proceedings include the debtor, creditors claiming their receivables, bodies representing the creditors (a creditors’ meeting and creditors’ committee, which is obligatory if the number of registered creditors reaches or exceeds 50), an Insolvency Court, and an insolvency administrator. The insolvency proceedings commence upon filing an insolvency petition by a legitimate person. Afterwards, the Insolvency Court decides whether the debtor is actually insolvent and, if so, which type of insolvency proceedings will be conducted.

The Insolvency Court always appoints an insolvency administrator. The insolvency administrator is a person possessing relevant professional expertise and qualifications who has passed a specialist examination and is listed by the Ministry of Justice.

**Types of Insolvency Proceedings**

Upon the declaration of the debtor’s insolvency by the Insolvency Court, the insolvency is dealt with under one of the following types of insolvency proceedings:

- Bankruptcy;
- Reorganisation; or
- Debt clearance.

In cases of bankruptcy, the debtor’s assets are sold and the creditors’ claims are proportionally satisfied using the proceeds of the sale. Unsatisfied claims do not cease to exist, unless stipulated otherwise by the Insolvency Code. Bankruptcy always leads to a liquidation of a debtor that is a legal entity.

By reorganisation, the debtor’s business is preserved and operated pursuant to an approved reorganisation plan under the supervision of the creditors. The creditors’ receivables are paid off gradually.
Debt clearance is available only for debtors who are not entrepreneurs. By debt clearance, all due obligations of the debtor are extinguished subject to the conditions stipulated by the Insolvency Court conducting the proceedings.

The Insolvency Code also provides for special means of addressing the insolvency of special sorts of debtors, such as banks and other financial institutions.

**Insolvency Court and Insolvency Petition**

Insolvency proceedings can be commenced only by an insolvency petition. There is no need for the Insolvency Court to rule on the commencement of the insolvency proceedings. The insolvency petition must be filed with a competent regional court. Generally, the competent court is the court in the district where the debtor has its place of residence (in case of physical persons) or statutory seat (in case of legal entities); if the debtor is an entrepreneur, the competent court is the court in the district where the debtor has its registered place of business. The insolvency proceedings commence immediately after the insolvency petition is filed.

The insolvency petition must contain certain essentials prescribed by the Insolvency Code, including (but not limited to) the proper identification of the petitioner and the debtor, relevant facts proving the debtor’s insolvency and the petitioner’s entitlement to file the insolvency petition and supporting evidence.

**Commencement of the Insolvency Proceedings**

As mentioned above, the insolvency proceedings are commenced on the basis of an insolvency petition. The insolvency petition can be filed with the respective court by the debtor or any of its creditors. In case of impending insolvency, the insolvency petition can only be filed by the debtor. If the debtor is a legal entity, it is obliged to file an insolvency petition without undue delay after it has actually learned that it is insolvent, or after it should have learned of its insolvency if it had exercised due care.

Within hours after the insolvency petition is filed, the Insolvency Court publishes certain details of the just-commenced proceedings in the central web-based registry of insolvency proceedings.

By the commencement of the insolvency proceedings, the property of the debtor (an estate) is affected in many ways. First of all, any claims and rights pertaining to the assets of the estate may not be brought before a court by an action, but only by registration filed with the Insolvency Court. Secondly, the insolvency proceedings affect security interests established over the individual assets forming the debtor’s property. Such security interests may only be enforced or established under the rules set forth by the Insolvency Code. Although any court may order judicial enforcement of a court decision relating to any assets of the debtor, such enforcement may not proceed while the insolvency proceedings are pending.

Furthermore, the debtor must keep ownership of its assets. It may not dispose of any assets pertaining to the estate if such disposal would diminish the value of the estate or substantially change the composition, utilisation or specification of the estate as a whole.

The debtor must also refrain from performing certain legal acts. The legal acts which would breach restrictions stipulated by the Insolvency Code would be ineffective in favour of the creditors. Hence, the creditors would be entitled to claim the ineffectiveness before a court. The restrictions relate mainly to the monetary obligations of the debtor incurred before the commencement of the insolvency proceedings, which may be performed only to the extent, and on the terms, set by the Insolvency Code. Generally, by way of example, the debtor may
perform only those monetary obligations which are necessary to operate its business as usual and to avoid any impending losses.

First Phase of the Insolvency Proceedings

The immediate first phase of the insolvency proceedings is the time period between the filing of the insolvency petition and the decision of the Insolvency Court on that petition. Once the insolvency proceedings have commenced, the creditors may register their claims with the Insolvency Court.

Where the debtor is an entrepreneur, the Insolvency Code supports operating the debtor’s business during this time period. The debtor carries on its regular business and continues paying the debts related to such regular business.

However, the debtor should not perform any acts which could be considered as preferential towards some of the creditors and to the detriment of others. Such preferential legal acts can be contested by other creditors or by the insolvency administrator (who may be appointed by the Insolvency Court in the upcoming phase of the insolvency proceedings) and declared ineffective by the Insolvency Court.

The Insolvency Court may also, in order to prevent changes in the extent of the property of the estate which are detrimental to creditors, grant a preliminary injunction (with or without a motion), in which the Insolvency Court orders the debtor to refrain from disposing of certain things or rights forming a part of the estate. The Insolvency Court may further order persons owing obligations to the debtor not to render performance to the debtor, but to an interim insolvency administrator.

Optional Second Phase of the Insolvency Proceedings – Moratorium

A debtor who is an entrepreneur may, within seven days after filing the insolvency petition or within 15 days after the insolvency petition was filed by a creditor, file a motion with the Insolvency Court to grant a protection period: a moratorium. The Insolvency Court must then immediately decide on that motion. A moratorium period can be granted only if the majority of creditors (calculated according to the amounts of their claims) consents in writing to granting of such a protection period.

The moratorium granted by the Insolvency Court brings various consequences. For example, an agreement for supply of utilities and raw materials, or for supply of goods and services, may not be rescinded or withdrawn by the other party during the protection period because of a payment default by the debtor which occurred before the granting of the protection period, or because of any decrease in the total assets of the debtor. This restriction applies only if the debtor duly pays the amount that became due during the protection period or within 30 days before the granting of the protection period.

The protection period may be granted for a maximum period of three months and may be extended by up to 30 days if the majority of the creditors (calculated according to the amounts of their claims) consent in writing.

Third Phase of the Insolvency Proceedings – Ruling on Insolvency

The Insolvency Court must, within 10 days after filing of the insolvency petition, take necessary measures which will result in its decision. The Insolvency Court must decide on the insolvency petition immediately, in any case no later than 15 days after the filing, if the insolvency petition was filed by the debtor itself.
The Insolvency Court declares that the debtor is insolvent if the debtor or the creditor who filed the insolvency petition properly proves that the debtor is insolvent, or is threatened with insolvency. After ruling on insolvency, the Insolvency Court decides which type of insolvency proceedings will be conducted: it may be the bankruptcy of the debtor, reorganisation or debt clearance.

The Insolvency Court will appoint an insolvency administrator no later than the issuance of the ruling on insolvency. After the ruling on insolvency, the Insolvency Court invites the creditors of the debtor to register their claims with the court and requests persons who have any obligations towards the debtor to render any future performance of their obligations to the insolvency administrator instead of the debtor. Furthermore, the right to set off receivables against the estate of the debtor is restricted.

Bankruptcy

If the Insolvency Court declares bankruptcy over the debtor, the debtor loses its right to manage and dispose of assets belonging to the estate. This right is transferred to the insolvency administrator together with all the debtor’s rights with respect to the estate. If the debtor does not adhere to these rules and performs any legal acts to which the debtor is not entitled, such legal acts will be ineffective vis-à-vis the debtor’s creditors. The creditors would then be entitled to claim the ineffectiveness before a court.

The insolvency administrator, in particular:

- Exercises rights of the debtor as shareholder, which are attached to the shares forming part of the estate;
- Performs legal acts towards the employees of the debtor as their employer; and
- Procures the operation of the debtor’s business (enterprise), keeping of accounting books and discharge of tax obligations.

The declaration of bankruptcy also brings consequences to the creditors. Generally, upon a declaration of bankruptcy, the creditors of the debtor may exercise their rights only under the terms and conditions and in the manner stipulated by the Insolvency Code. Additionally, all of the creditors’ claims against the debtor which are not yet due become due and payable, except in some special cases set forth by the Insolvency Code.

Reorganisation

Another mechanism for dealing with insolvency is reorganisation. Reorganisation is available to debtors who are physical persons as well as entities, provided that the total turnover of such debtor reaches at least CZK 50,000,000 (approximately EUR 1,825,000 or USD 2,500,000) or such debtor employs at least 50 employees. A reorganisation is not possible if the entity is in liquidation.

The motion for allowing the reorganisation may be filed by the debtor or by any of the creditors who registered their claims in the insolvency proceedings. However, such person must believe in good faith that the conditions stipulated for an approval of a reorganisation plan are or will be fulfilled. The debtor is only allowed to propose reorganisation before the court rules on its insolvency. Thereafter, the right to propose reorganisation remains only with the creditors having registered claims, who may file such a motion no later than 10 days before the first creditors’ meeting after the Insolvency Court decides on the insolvency of the debtor.
The Insolvency Court approves the reorganisation, unless: it is justified to presume that, with regard to all circumstances, the motion pursues an unfair intention; the motion was filed by a person on whose motion for approval of reorganisation has already been decided by the Insolvency Court; or the motion was filed by a creditor and the creditors’ meeting did not approve such motion. If the motion was filed by the debtor, there is no need for approval by the creditors’ meeting.

If the Insolvency Court approves the motion on reorganisation, the debtor has a priority right to produce a key document of the reorganisation: the reorganisation plan.

The Reorganisation Plan

The reorganisation plan stipulates the legal standing (rights and obligations) of the concerned persons as a result of the approved reorganisation. This legal standing is set by the measures stipulated in the reorganisation plan, which aim at revitalisation of the debtor’s business, and through the regulation of mutual relationships between the debtor and its creditors. The upcoming proceedings of the reorganisation must be conducted in harmony with the approved reorganisation plan, unless the reorganisation plan is amended accordingly.

The Insolvency Court must approve the reorganisation plan if: the plan is prepared in accordance with the Insolvency Code and other laws; it is justified to presume, with regard to all circumstances, that no unfair intention is pursued by the plan; the plan was approved (or is deemed approved) by each class of the creditors; each creditor receives performance of at least the same value as it would receive if the insolvency was dealt by bankruptcy, unless the receiving creditor agrees to a performance of lower value; and all claims against the estate are to be paid upon the reorganisation plan becoming effective.

Reorganisation can be performed (by way of example) by the following actions: restructuring of creditors’ receivables; sale of the entire estate or a part thereof; sale of the debtor’s enterprise; surrender of a part of the debtor’s assets to a creditor or to a newly established legal entity in which a creditor holds equity shares; merger of the debtor (in case the debtor is a legal entity) with another legal entity or transfer of its equity to a debtor’s shareholder or participant; issue of shares; change in debtor’s statutes; or raising of financing of the debtor’s enterprise or a part thereof.

The Insolvency Court may decide upon changing the reorganisation procedure into a bankruptcy, unless the reorganisation plan has already been fulfilled in its substantial elements. The Insolvency Court will issue a decision acknowledging the fulfilment of the reorganisation plan. By this decision, the reorganisation comes to an end.

Debt Clearance

Debt clearance (discharge of debts) is a manner of resolving the insolvency of natural persons or non-entrepreneurial legal entities. It does not guarantee a complete financial indemnification to the creditors. It is often used as a solution for so-called consumer insolvency, where the debtor’s debts are drawn together, secured creditors are satisfied to the full extent, the unsecured creditors are satisfied to some agreed extent, and the rest of the debts are discharged, meaning that such debts remain only as unenforceable obligations.

The proposal for permission for debt clearance may be filed exclusively by the debtor itself along with the insolvency petition. In the event that a creditor rather than the debtor files the insolvency petition, the debtor may, within 30 days after the insolvency petition is delivered to the debtor, file a proposal for permission for debt clearance.
For permission for debt clearance, it is primarily necessary to define how debt clearance will be carried out. The Insolvency Code offers two alternative methods for debt clearance: either a sale of assets or the setting and fulfilment of a payment calendar.

A decision about the manner of debt clearance rests upon the unsecured creditors. The decision is taken into consideration by the Insolvency Court when it considers the proposal. If the Insolvency Court rejects the proposal, insolvency is automatically resolved through bankruptcy.

In cases of a converting sale of the debtor’s assets, the insolvency administrator performs the sale and proceeds to act in a way similar to that of bankruptcy. The sale does not touch the rights of secured creditors.

In cases of setting a payment calendar, the debtor is, for a period of five years, obliged to pay to the unsecured creditors monthly instalments amounting to a specified part of the debtor’s income. The debtor, through the insolvency administrator, distributes this amount among the unsecured creditors pro rata in a manner determined by the Insolvency Court. Secured creditors are satisfied only from the proceeds of the security. By repayment according to the payment calendar, at least 30% of claims of unsecured creditors must be satisfied, unless the unsecured creditors agree otherwise. If the debtor is in default with respect to its obligations under the payment calendar for longer than 30 days, bankruptcy will be automatically declared.

The debtor is supervised by the insolvency administrator, the Insolvency Court and the creditors’ committee. The debtor has to submit a summary of its income in the previous period to all relevant creditors every six months.

The Insolvency Court terminates debt clearance proceedings after five years from the decision on permission of debt clearance when the debtor fulfils all obligations set forth by the Insolvency Court duly and in time. The debtor is then entitled to file a proposal for discharge of payment of all claims which were not satisfied so far. Such claims survive as unenforceable obligations.

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Egypt

Overview and Introduction

As in other jurisdictions, the primary objective of the Egyptian insolvency and bankruptcy regulation (collectively, the “Insolvency and Bankruptcy Regulation”) is to protect and maximise the value of the bankrupt company for the benefit of all the creditors. The bankruptcy regulation was substantially overhauled and culminated in what was perceived to be a “more modern bankruptcy regime”, which came into operation on 1 October 1999. However, the Egyptian Insolvency and Bankruptcy Regulation remains lacking and requires an in-depth review. Indeed, various parts of the legislation need to be updated, and the relevant legislation requires further consolidation for easier understanding and application.

Applicable Legislation

The Insolvency and Bankruptcy Regulation in Egypt is scattered among the Civil Code of 1948, Companies Law No. 159 of 1981, and the bankruptcy rules under Trade Law No. 17 of 1999 (“Trade Law”). It is worth noting that Egyptian law differentiates between insolvency, which is regulated under the Civil Law, and bankruptcy, which is regulated under the Trade Law.

In this respect, the Civil Law provides that a debtor may be declared insolvent if his assets are insufficient to pay his due debts. The insolvency rules, as regulated by the Civil Law, apply to non-traders with regards to non-commercial debts.

Meanwhile, bankruptcy rules, as regulated by the Trade Law, apply to traders who, according to said law, are bound to hold commercial registers. According to the Trade Law, a trader shall be considered in the state of bankruptcy in the event he stops paying his commercial debts following disturbance of his financial business. It should also be noted that, in order to apply the provisions of bankruptcy, the competent court in Egypt should issue a judgment declaring the bankruptcy of the trader.

Bankruptcy

Jurisdiction of the Bankruptcy Court

According to the Bankruptcy Regulation, the Economic Court, pursuant to Law No. 120 of 2008, assumes jurisdiction over a bankruptcy petition/dispute if:

- The debtor is domiciled and trading in Egypt;
- The debtor is a branch or an agency of a foreign entity, even if not declared bankrupt in the country of original nationality (without prejudice to any international treaty to which Egypt is a party); or
- The debtor has been ordinarily resident (or has had a place of residence) in Egypt, or has carried out business in Egypt and is dead or has ceased trading, provided that the petition is filed at any time within the period of one year ending on the day the petition is presented.

Bankruptcy Petition

According to the relevant Bankruptcy Regulation, the bankruptcy petition may be filed by any of the creditors holding commercial debt, by the debtor, by the Public Prosecutor or by the court. It is worth noting that a company’s legal representative may not request that its
bankruptcy be declared except after obtaining permission for such request from the majority of the partners or the General Assembly, as the case may be.

In order for the petition to be accepted, there must be evidence that:

- The debtor is a commercial entity;
- The debt is a commercial debt which is due and undisputable, or a civil debt provided that the debtor has not settled his due commercial debts in addition to his civil debts;
- The debtor was not able to pay its debts; and
- The non-payment is a result of financial distress.

Notwithstanding the foregoing, a debtor is legally required to present a petition for a bankruptcy order against itself within 15 days from the date of stopping payment of its commercial debt. The advantages that a debtor may enjoy by presenting a bankruptcy petition include the following:

- If a bankruptcy order is made, the debtor relinquishes virtually all its property in return for being freed from the accumulated burdens of its debts and for being given a chance, in due course, to make a fresh start;
- The debtor avoids the inconvenience and dissipation of resources caused by multiple executions and other forms of enforcement processes;
- All ordinary creditors are dealt with in the most equitable way possible through a collective process, whereby the debtor’s assets will be rateably shared by the creditors in proportion to the debts that were owed; and
- During the bankruptcy proceedings, the bankrupt (i.e. the debtor) may start new trading activities with fresh assets. In turn, the creditors arising from the new trading activities enjoy priority over the pre-bankruptcy creditors.

Despite the advantages, the court has a wide discretion to dismiss the bankruptcy petition and will do so if it is of the view that the petition is an abuse of the process.

Commencement of Bankruptcy

Bankruptcy of an entity against whom a bankruptcy order is being made commences the day the order is issued.

Upon issuing the bankruptcy order, the official receiver acts as the trustee of the bankrupt and must take all steps necessary to protect the bankrupt’s estate.

In addition, upon the appointment of the official receiver (who also acts as a trustee), all property belonging to or vested in the bankrupt at the commencement of the bankruptcy shall vest in the official receiver. Accordingly, the bankrupt is under a duty to deliver up any part of its estate that is in its possession or under its control to the official receiver. In addition, any person, including bankers, lawyers, employees, partners and employers of a bankrupt, who possesses property of the bankrupt must pay for or deliver to the official receiver all the debtor’s property that they are not entitled to retain.

Upon issuance of the bankruptcy judgment, all creditors, whether ordinary creditors or privileged creditors, are prohibited from independently initiating any lawsuit or undertaking any judicial proceedings in this regard. Also, the issuance of a bankruptcy judgment entails a
stay of proceedings in relation to any ongoing lawsuit initiated prior to the opening of bankruptcy proceedings against the debtor in question and yet to be adjudicated as of the date of the declaration of bankruptcy.

The state of moratorium is not applicable to creditors with special privileges.

Bankruptcy Process

There are a number of notices sent to creditors in the course of bankruptcy proceedings. Such notices include the general notice for creditors to present their claims, the notice to secured creditors allowing them to enforce their rights against the pledged assets of the debtor, the notice sent to creditors for the appointment of the bankruptcy trustee and controller, etc. Among the most significant notices is the general notice for creditors in relation to the lodging of their claims, based on which the composition of creditors may or may not be approved.

Creditors can assert an estate’s remedies and defences against third parties and are explicitly afforded a right to pursue any third party who is indebted to their debtor.

Creditors’ meetings can be organised by the largest creditors, inviting other creditors of the bankrupt entity to meet. Alternatively, the secretary of the bankruptcy court can assist calling in for such meetings inasmuch as the information relating to the various creditors would be readily available before the court. The composition of creditors, if any, would possess all the updated information regarding their debtor, including outstanding debts, maturity dates, and ongoing litigations, out of court settlements or reschedulings. The administrator’s obligation is to assist all creditors in gathering such information and to cooperate with the latter so that no unfair advantage is extended to any particular creditor.

Voluntary Arrangement and Interim Order

This incentive was introduced with the objective of providing a “breathing space” or a moratorium for the debtor to reorganise its financial affairs and propose an arrangement that is acceptable to its creditors, should the court find that the financial position of the company is capable of being enhanced in the interest of the national economy. During this breathing space, which is limited to three months, no bankruptcy, enforcement or other proceedings can be brought or continued against the debtor without the leave of the court. Also, the court may order any measures it deems fit to protect the assets of the debtor during this three-month period.

Corporate Restructuring

Reorganisations, Restructurings and Workouts

There is no Chapter 11 or voluntary administration procedure in Egypt, so workouts are essentially contractual arrangements that are mutually agreed between the debtor company and its financial creditors without any need to involve the court. The aim is to achieve the continuation of the company’s business without the need to commence winding-up proceedings. However, the bankrupt debtor may request a reconciliation to avoid bankruptcy provided that the debtor did not commit fraud or an error that does not emanate from an ordinary trader, and that his financial situation was disordered in a manner leading to his bankruptcy.

Also, it should be noted that Article 702 of the Trade Law authorizes the court on its own, or upon the request of a debtor which is an entity, to postpone considering the bankruptcy request for a period not exceeding three months if the financial situation of the entity may be restored or if a postponement is required to preserve the national economy.
Terms of the Restructuring or Workout

The terms of the restructuring or workout arrangement are set by the parties involved through commercial negotiation and often involve reorganisation of the company’s business.

Reaching a restructuring arrangement requires all creditors to agree on suitable terms to prevent any dissenting creditor from commencing winding-up proceedings or seeking to enforce any judgments already obtained.

Debt Rescheduling

Restructuring or workouts often involve rescheduling the debt, whether matured or otherwise, of the company facing financial difficulties. The company will often seek to convince creditors not to demand or insist on full payment of debts.

Besides deferring payment, parties can agree to reduce, cancel or waive part of the principal amount of indebtedness and/or part or all of the accumulated interest.

Multiple Bank Restructurings

The restructuring of large corporations frequently involves multiple bank entities that often constitute the major creditors. Generally, banks will be prepared to embark on a restructuring only if the prospect of eventual recovery is greater than it would be if the company was put into liquidation. Cooperation and recognition of shared interests is integral to a successful restructuring or workout process.

Successful Reorganisations

The Trade Law does not have specific or elaborate provisions to regulate reorganisation plans. The composition of creditors plays a vital role as to whether a plan, if and when prepared by the debtor, will be approved or rejected. Superseding the powers of the composition of creditors stands the Economic Court and a judge who, by virtue of Article 643 of the Trade Law, has discretion to allow the sale of the debtor’s property during the period between presentation of the petition and issuance of the bankruptcy order, if doing so will realise positive benefits for the creditors or the bankrupt. Therefore, there are no mandatory features of a reorganisation plan to be approved, and the composition of creditors, despite the process described above, may be impeded from implementing any given reorganisation plan if so instructed by the court.

Corporate Bankruptcy/Liquidation

Types of Liquidation

Egyptian law recognises two types of liquidation: shareholders’ voluntary liquidation; and compulsory liquidation.

In general terms, solvency is assessed on a cash flow basis for going concerns, which is the ability of a business entity to pay its creditors. However, after the bankruptcy process is underway, solvency is assessed when the entity can no longer meet its debt obligations as they become due. The financial consequences largely depend on the outcome of the foregoing assets/liabilities equation, as follows:

- The result is positive: the liquidation will be solvent, the creditors will receive complete recovery and there could be a return to shareholders;
The result is negative: the liquidation is insolvent and there will be a shortfall of assets, which will result in a shortfall to creditors without any residuals remaining to the shareholders.

The outcome of the assets/liabilities equation controls the liquidation method that the company is capable of pursuing. The available methods are discussed below.

Shareholders’ Voluntary Liquidation

This is only available where the company is bankrupt. According to the Egyptian Companies Law, if the company’s losses exceed 50% of its paid-in capital, then it issues an extraordinary general assembly resolution to either liquidate the company or continue trading. If the decision is to liquidate the company, then the shareholders must appoint a liquidator who will work under the supervision of the general assembly.

In broad terms, the extraordinary general assembly’s resolution to put the company into liquidation is usually passed on the basis that the company cannot continue its business due to its liabilities. As the company is insolvent, the company has to appoint a liquidator. Once the liquidator is appointed, he must serve a meeting notice on the company’s creditors. The liquidator must then try to reach an agreement with the creditors. If an agreement is not reached, then the liquidator may be required to request permission to file for bankruptcy from the company’s general assembly or ask the shareholders to inject money to cover any outstanding debts.

The Court’s Role in a Voluntary Liquidation

Shareholders’ voluntary liquidation is subject to the court’s supervision. This means that stakeholders (e.g. the liquidator, creditors, shareholders, etc.) may apply for the court’s directions as to how to conduct aspects of the liquidation. These liquidations can proceed with little or no guidance from the court. Voluntary liquidations can therefore provide an opportunity for a more managed liquidation process.

Compulsory Liquidation

A company may be wound up by the court on a number of grounds, most often in an insolvency situation due to the debtor’s inability to pay its creditors. There is also a broad discretionary power under which the court can order a company to be wound up where it is just and equitable to do so.

Application to Court

The application to the court to wind up a company may be made by a creditor, a shareholder or the company itself by virtue of a winding-up petition. Once the petition is issued, the winding-up of the company is deemed to have commenced.

Uncontested Cases

In a typical uncontested case, the process should run swiftly and conclude with a winding-up order being issued against the company.

The Court’s Supervisory Role

The court maintains a supervisory role throughout the administration of the compulsory winding-up of a company. The court’s approval is also required for certain matters, including the appointment of provisional liquidators and liquidators who act as officers of the court in managing the company during the compulsory liquidation or restructuring process.
Powers of a Provisional Liquidator

When a winding-up petition has been presented to the court, the court may order the appointment of one or more provisional liquidators (either the official receiver or a private insolvency practitioner). Appointment of a provisional liquidator typically takes place in cases where the company's assets are in danger or there has been an allegation that the management of the company has misappropriated the company's assets.

The purpose of appointing a provisional liquidator is to maintain the status quo of the company along with its assets and records. The order of the court appointing the provisional liquidator will specify the functions to be carried out in conjunction with the powers conferred upon him.

Powers of the Directors Cease

The company's management ceases to act as the authorised agents of the company upon the appointment of a provisional liquidator (or a court-appointed liquidator-trustee). This simply means that, upon the appointment of the provisional liquidator, the managerial and operational powers of the directors in the company are vested in the provisional liquidator. The company's managers/directors retain a limited non-managerial residual power. Decisions regarding the operation of the company are vested in the provisional liquidator from the time of his appointment and the directors' powers are suspended at that time.

Priority of Claims

In bankruptcy proceedings, the assets available to the company are usually insufficient to satisfy all of the creditors' claims in a manner preventing the disturbance of the business. As a result, the priority or order of ranking of different claims is of utmost importance. In general, claims are ranked in the following order:

- Costs and expenses properly incurred in preserving, realising or bringing in the assets of the company, including the liquidator's remuneration and disbursements;
- Preferential creditors (e.g. certain debts due to employees or the government);
- Secured creditors;
- Ordinary unsecured creditors (including any shortfall arising from secured creditors after realisation of their security); and
- Shareholders.

Pari Passu Principle of Distribution

A general principle of pari passu distribution is applied, which means that ordinary creditors should rank equally amongst themselves.

Set-Off and Netting

Pursuant to the Insolvency and Bankruptcy Regulation, set-offs apply where there have been mutual credits, mutual debts or other mutual dealings prior to the company going into liquidation. Although mutual dealings need not be in relation to the same transaction, they must be between the same parties. In addition, mutual dealings are not restricted to debts incurred under contracts. In such circumstances, an account is taken of what is due from each party to the other in respect of the mutual dealings with the sums due from one party being set off (settled) against the sums due from the other. A set-off in a liquidation will result in only one sum owing with the net balance being paid to (or due from) the liquidator. To the
extent that a set-off is available, the creditor receives 100% of the relevant amount and is in a better position than unsecured creditors who are relying on a *pari passu* distribution.

A set-off will be possible if and when the debt of both the creditor and debtor find their source or emanate from the same dealing, contract or tort. Any right of set-off or netting in the course of bankruptcy proceedings is subject to the prior approval of the bankruptcy judge.

**Clawback and Recovery Mechanisms**

In all forms of liquidation, liquidators are empowered to investigate the affairs of a company and seek redress from the court where it considers that assets belonging to the company have been dissipated. If an order is made by the court, the relevant directors, company officers or creditors may be required to repay or restore the property to the company, or contribute to the assets of the company as the court considers appropriate. Below are some examples of possible offences that liquidators may investigate.

- **Unfair preference**: the liquidator may challenge creditors who have received payments from the company and may have received preference over other creditors;

- **Disposition of property with intent to defraud creditors**: transactions of this nature are voidable at the instance of the person prejudiced by the disposition, except where such disposition is for valuable consideration and in good faith to any person not having, at the time of the disposition, notice of the intent to defraud creditors;

- **Disposition after commencement of compulsory liquidation**: these dispositions or payments are void against the liquidator and the recipients of these funds or assets must return the funds or assets to the liquidator;

- **Fraudulent trading**: where the business is carried out with intention to defraud creditors or for any other fraudulent purpose; and

- **Misfeasance**: where directors have breached their fiduciary duties to the company or have misapplied or retained company property for their personal benefit.

**Disclaimer of Onerous Contracts**

Where a company has entered into unprofitable contracts or its assets include land burdened with an onerous covenant, shares or stock in companies, or unsalable property, the liquidator may, with leave of the court, surrender or disclaim that contract or property or request that the court keep the contract in effect. The disclaimer is binding on the rights and interests of the company and will release the company and the property of the company from liability as far as necessary.

**Court-Approved Arrangements and Reconstructions**

The court also has jurisdiction to sanction certain arrangements. Such arrangements may include primarily entering into a compromise or arrangement between the company and its creditors or any class of them, or between the company and its shareholders (or any class of them) upon the application of the company, or any creditor or member of the company.

**Funding in Bankruptcy Proceedings**

There are no specific provisions under Egyptian law for lending in bankruptcy proceedings. However, it is possible for a company to obtain financing from a willing lender when it is
under bankruptcy proceedings pursuant to contractual arrangements. It is not uncommon for a liquidator to obtain financing from creditors to conduct investigations or litigation.

Priority Ranking for Post-Liquidation Borrowing

Where a lender is willing to provide new funds for the purpose of preserving and realising the assets of a company, such post-liquidation borrowing of the company is treated as an expense properly incurred by the liquidator and has priority over any other pre-liquidation debts.

In addition, although the general principle of *pari passu* distribution applies to unsecured creditors, Egyptian law provides that where a creditor has undertaken a substantial risk when giving the liquidator an indemnity for costs in litigation, the court may grant the creditor in question a greater share of the particular assets recovered than would be normal under the *pari passu* principle.

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England and Wales

Overview and Introduction

England and Wales have a number of insolvency and general company law procedures which can be used either to restructure a company and its finances or, where restructuring is not possible, to maximise realisations for creditors. This Guide contains an overview of the restructuring and insolvency regimes which exist in England and Wales.

Applicable Legislation

The insolvency regime in England and Wales is principally governed by the Insolvency Act 1986 and the Insolvency Act 2000 (together the “Insolvency Act”) and their associated rules and regulations. Much of the detail of the formal insolvency regimes discussed in this Guide can be found in the Insolvency Rules 1986 (the “Rules”). Both the Insolvency Act and the Rules have been the subject of much amendment since they initially came into force. It is currently envisaged that the Rules will be replaced by the Insolvency Rules 2015. These are currently available in draft form but remain subject to further review. The amendments are not always easy for the uninitiated to fit into the scheme of legislation, and when reading either set of legislative rules care should be exercised to ensure that the most up-to-date versions are being referred to. This legislation governs both personal and corporate insolvency though only corporate restructuring and insolvency is dealt with in this Guide. The Insolvency Acts and the Rules contain the statutory provisions relating to:

- Company voluntary arrangements (“CVAs”);
- Administrations (both court-based and out-of-court appointments);
- All types of liquidations (“winding up”); and
- Administrative receiverships.

In addition to the rules relating to these procedures, the Insolvency Act and the Rules detail the law relating to wrongful trading, fraudulent trading and other matters which affect officers of companies (including shadow directors; see below) who run into financial difficulty.

Some important provisions that need to be considered in relation to any restructuring are contained in the Companies Act 2006 (the “Companies Act”). In particular Parts 26 and 27 of the Companies Act contain provisions relating to the scheme of arrangement procedure. Since 2007 and the start of the credit crisis this procedure has become an increasingly popular mechanism for both UK and non-UK based companies to restructure their finances. It is explained in more detail below.

In addition to these procedures a brief description will also be given of how certain secured creditor remedies fit into the restructuring and insolvency marketplace as these can sometimes be useful in achieving the objectives of a restructuring plan.

In relation to the international aspects of restructuring and insolvency law in England and Wales there are numerous important legislative provisions. The Cross-Border Insolvency Regulations 2006 implemented the UNICITRAL Model Law on Cross-Border Insolvency and provide for the recognition of non-UK insolvency office-holders in formal insolvency proceedings initiated overseas. The European Regulation on Insolvency Proceedings, Council Regulation (EC) No 1346/2000 (the “EU Insolvency Regulation”) is applicable throughout the EU (except Denmark) and provides for a comprehensive EU-wide recognition regime in relation to insolvency proceedings (but not certain security enforcement
The EU Insolvency Regulation is dealt with in a separate chapter.

A volume of secondary legislation exists in relation to the financial markets, partnerships and certain industry sectors (e.g., investment banks, insurers, credit institutions, railways) which is beyond the scope of this Guide.

The Test for Insolvency

It is helpful at the outset to understand the basis on which a company is considered to be insolvent under English law as this can act as a trigger for the application of the legislation, for example, the law relating to directors’ personal liability for wrongful trading.

A company is considered to be insolvent under English law if it is unable to pay its debts. Section 123 of the Insolvency Act 1986 contains a definition of inability to pay debts.

The first is the cash-flow test, under which a company is insolvent if it is proven to the satisfaction of the court that the company is unable to pay its debts as they fall due. Section 123 of the Insolvency Act 1986 sets out the circumstances where a company is deemed unable to pay its debts. These include the failure of the company to meet a statutory demand for a sum of more than £750. If none of the specific grounds for cash-flow insolvency are proven then it is still possible to adduce other evidence showing an inability to pay debts as they fall due. This usually means providing the court with the relevant accounting evidence based not just on past statutory accounts but also the current financial position of the relevant company. It can be difficult for third parties to gain access to such information.

The second is known as the balance sheet test for insolvency. Under this test a company is deemed unable to pay its debts where it is proven to the satisfaction of the court that the value of the company’s assets is less than the amount of its liabilities taking into account its contingent and prospective liabilities. Establishing balance-sheet insolvency without access to all company records can be difficult if there is a dispute, for example, over the proper valuation of assets or liabilities.

Classes of Creditor – A Brief Summary

It is helpful in understanding what follows in this Guide if a brief explanation of the broad categories of priorities attaching to creditor claims in insolvency cases is given. The priority of a creditor’s claim may be influenced by a number of factors that are dependent on the circumstances of a case. For example, the time any relevant security is created (e.g., before or after any other security), the manner of registration, the giving of notice or, in a few cases, the conduct of the creditor may all affect the outcome of a dispute as to priority. A detailed review of the law in this respect is not appropriate here, but outlining three broad categories of claim will help demonstrate how different types of claims are affected by formal insolvency processes.

A secured creditor is one who has a security over, or proprietary interest in, the debtor’s assets which must be respected in any formal insolvency. Fixed charges, security assignments and legal mortgages are generally the highest ranking security that can be obtained. A floating charge is the next highest ranking. The floating charge’s major disadvantage on an insolvency of the debtor is that unlike a fixed charge it is postponed to the claims of preferential creditors and the expenses of the insolvency office-holder. Additionally, a portion of floating charge realisations is also set aside as a fund to be paid to unsecured creditors. This is sometimes referred to as the “prescribed part” fund.
A preferential creditor is one whose claim is afforded a priority over a floating-charge-holder’s claim to the proceeds of sale of floating charge assets and the general body of unsecured creditors. The claim ranks behind the claims of fixed-charge holders insofar as sale proceeds of assets subject to that fixed charge are concerned. The most important preferential claim is that owed to employees of the insolvent company in respect of unpaid wages and holiday pay up to a statutory limit which changes from time to time. Other categories of preferential claim are listed in the Insolvency Act.

Finally an unsecured creditor ranks behind the creditors set out above, but ahead of a shareholder’s claim for the return of his capital.

Thus, in a liquidation, the order in which the insolvent company’s estate will be applied is:

- Fixed-charge-holders’ claims;
- Expenses of the insolvency;
- Preferential claims;
- Prescribed part fund (paid to unsecured claimants pro rata out of floating charge proceeds);
- Floating charge claims;
- Unsecured claims; and
- Return of capital to shareholders in accordance with their rights.

Corporate Restructuring and Insolvency

The following formal insolvency regimes exist for UK companies:

- Company voluntary arrangements;
- Administration;
- Administrative receivership;
- Liquidation; and
- Schemes of arrangement.

Company Voluntary Arrangements

The directors of a company or, if the company is in administration or liquidation, its insolvency officer can propose a company voluntary arrangement (“CVA”). If the directors intend to implement a CVA they will need the help of a licensed insolvency practitioner from the outset. The proposal is made to the creditors and the shareholders of the company. The CVA may compromise the debts of the company and is similar in its effect to a scheme of arrangement (described below in “Scheme of Arrangement”). Indeed, the CVA proposal often follows the format of the scheme document for a scheme of arrangement, particularly in cases involving large companies. Subject to certain restrictions, the legislation governing CVAs allows for considerable flexibility. They may be used in appropriate circumstances to protect or preserve the value of shareholdings whilst at the same time removing a considerable amount of unsecured debt from the balance sheet. An important difference
between CVAs and schemes of arrangement is that to undergo a CVA a company must be insolvent. This is not necessary in the case of a scheme of arrangement.

Procedure

It is necessary to prepare a CVA proposal document with the assistance of a suitable licensed insolvency practitioner, known at this stage as the nominee. The proposal details how existing difficulties have occurred, how they are to be overcome and why creditors should be expected to approve what is proposed. The provisions of any CVA may be tailored to fit the circumstances, subject to certain statutory criteria as to content. Typically, an arrangement may propose an investment by an existing or new shareholder for working capital purposes, partial forgiveness of unsecured creditor debt and/or a commitment by the company to make payments from future profits into a CVA fund for subsequent division amongst existing creditors. The process of collection and distribution of the CVA fund (and/or any other management of the fund required by the CVA) is conducted by a licensed insolvency practitioner known as a supervisor once the CVA has been approved.

The meetings of shareholders and creditors must be convened on at least 14 days’ notice. The proposals are considered at these meetings and approval may be given or modifications made. Typically the shareholder and creditor meeting will take place on the same day. The CVA needs to be approved by a simple majority of shareholders and by 75% in value (of those present at the meeting in person or by proxy and voting) of unsecured creditors; there is a further requirement that at least 50% of those unsecured creditors voting to approve the CVA should not be connected with the company.

Secured and Preferential Creditors

The rights of secured and preferential creditors cannot be affected by a CVA unless they give their consent. This can be an important issue and needs to be addressed early in the process of putting together a CVA.

Creditor Moratoria

Small companies whose directors are considering a CVA proposal (as defined in the Companies Act 2006) may apply for a moratorium on certain creditor rights. Such a moratorium may last for between one and three months. The moratorium would prevent enforcement of security and other creditor action being taken and is designed to give the company a breathing space in which to put together a viable CVA proposal.

For larger companies the moratoria applicable to small companies is not available. For this reason, in cases where it is desirable to hold off creditor action pending implementation of a rescue plan the choice can be made to shelter a proposed CVA under the umbrella of an administration, which does impose wide-ranging moratoria. This is discussed below in “Administration”.

Effect of Approval

If the CVA is approved by the required majorities of shareholders and creditors it becomes effective, thereby binding dissenters and those who did not vote, as well as those who did not receive notice of the meeting. The nominee will typically become the supervisor of the CVA and set about managing its implementation. If a shareholder or creditor believes that the CVA unfairly prejudices its position there is a procedure whereby it may apply to the court for relief. The courts have a wide discretion to tailor relief to fit the particular circumstances of an application, or in extreme cases to order that the CVA not be implemented despite the results of the meetings held. The fact that a CVA has been
approved must be filed at Companies House, and anybody searching the register of companies will become aware of its existence.

Note that a CVA does not result in a court judgment which can be enforced or recognised in other jurisdictions. The EU Insolvency Regulation may assist a supervisor to be recognised in the member states of the EU. In other jurisdictions local law must be assessed and applications made, if possible, for recognition of the supervisor.

Implementation

The CVA proposal document will normally set out the scheme and timeline for implementing the CVA. It may contain detailed rules for the submitting and assessment of claims and may also provide for undertakings to be given by the company in respect of assets disposals, etc. It will also normally contain protective provisions for any supervisor. Criteria may be contained in the CVA proposal document that allow the supervisor to terminate the CVA if certain events occur or payments are not made.

Administration

Administration is a process which can lead either to the restructuring and eventual return to health of a company, or to it winding up after the realisation of its assets in a more efficient manner than would be possible under a liquidation or administrative receivership. An administration may run in parallel with some other procedures described in this Guide such as a CVA or a scheme of arrangement. Where a restructuring is considered it is likely that an administration will be used to impose a moratorium while a CVA, scheme of arrangement or pre-packaged sale is put in place. More is said about pre-pack administrations, which have become a popular restructuring tool, at the end of this section.

Application for an Administration Order

There are two separate routes for a company to enter into administration, but in both cases it must be established that a company is unable to pay its debts or, where the appointment of the administrator is by the holder of a qualifying floating charge (i.e., one which, together with other security, extends to the whole or substantially the whole of the relevant company’s property), that the security has become properly enforceable.

An administrator may be appointed out of court by a company, its directors, or a holder of a qualifying floating charge. The appointment is made by filing, with the court, a notice of intention to appoint an administrator together with certain prescribed papers. The filing of these papers can be done very quickly in urgent cases, and there is normally no court hearing necessary for an order appointing the administrator.

Alternatively an application can be made to court for an administration order by directors, shareholders or a creditor of the company. In such cases a court hearing will take place on the merits of the application. In urgent cases the hearing can be expedited.

Moratorium on Creditor Rights

Once the notice of intention to appoint (the out-of-court route) or application to the court (the court route) is filed, an interim moratorium automatically comes into effect. This prevents a wide range of creditor enforcement action from being taken against the relevant company. Once the administration has commenced, the interim moratorium becomes a permanent statutory moratorium and prevents creditors from enforcing rights against the company without first obtaining the consent of the administrator or the leave of the court. It prevents the company from being wound up, security over its assets from being enforced or the goods held under leases or hire purchase agreements from being repossessed. The moratorium
does not extend to the exercise of set-off rights although difficult questions may arise where steps need to be taken against the company before such rights become effective. In addition, the holder of certain qualifying floating charges or floating charges pre-dating 15 September 2003 may appoint an administrative receiver if he so wishes, which means he effectively has a right of veto over an administration. These rights are explained in more detail in “Administrative Receivership” below.

The moratorium subsists for the duration of the administration.

Purposes of the Administration

In all administrations the prospective administrator must file papers with the court that indicate his willingness to act and his opinion that the purposes for which the administration order is made are capable of being fulfilled.

The objective of an administration is primarily to try and achieve a rescue of the company. If that is not reasonably practicable, the aim is to achieve a better realisation of assets than would be effected on a winding up of the company; and only if that is not reasonably practicable, to realise assets in order to make a distribution to one or more secured or preferential creditors. At all times, the administrator has a duty to act in the best interests of the creditors as a whole.

Effect of an Administration

On appointment the administrator becomes responsible for the management of the company and the powers of the directors cease. The administrator has wide powers of management and disposal over the assets of the company. He may in certain cases sell assets used by the company but which it does not own, or which are subject to fixed security interests where this is required to maintain the viability of the business. The rights of the owner of the asset can be adequately protected in some other manner, for example, by payment over of the proceeds of a sale. The administrator also has access to the assets of the company which are subject to a floating charge (primarily stock in trade and possibly book debts) in order to fund the administration and pay his costs and expenses. The administrator has the power to cause the company to continue to pay the salaries/wages of employees. However if he subsequently decides that the company no longer requires the services of any individual, he will be able to dismiss that person, leaving only an unsecured claim in damages against the company which cannot be proceeded on unless the moratorium is lifted. (If the business is sold the relevant employees’ rights may be enforceable against the purchaser under certain employment protection legislation.)

The administrator is obliged to convene a meeting of creditors as soon as reasonably practicable and no later than ten weeks after the company enters administration. At the meeting he must explain how he proposes to achieve the objectives of the administration. The creditors can vote to approve these proposals or suggest modifications. An administrator must act in accordance with the proposals or seek further approval from the creditors or in some circumstances directions from the court. The proposals put forward by the administrator at the meeting are normally general in nature, for example, stating that a scheme of arrangement will be put forward and outlining the broad parameters of the scheme.

When the objective of the administration has been achieved or 12 months after appointment, whichever occurs first, the administrator is obliged to vacate office. He may vacate office earlier if it becomes apparent the purposes for which the administration was made cannot be achieved. The initial 12-month duration of an administration can be extended once, for up to six months, by creditor consent or for longer time periods by the court upon application if necessary. If the administration succeeds in rescuing the company once the administration
ends the company is returned to its directors and shareholders. If no rescue is implemented the company may be wound up after the administration has terminated.

Creditor Claims

An administrator is entitled in certain circumstances to distribute the proceeds of realisation of the company’s estate to unsecured creditors. This can only be done where the court has granted permission. The central question will be whether it is in the best interests of all of the creditors. The claims of the unsecured creditors are determined under procedures laid down in the Rules. The administrator must set aside for distribution to the unsecured creditors a fund from the net proceeds of assets otherwise available to a floating-charge-holder (calculated on a sliding scale but subject to a maximum of GBP600,000 per company), unless the sums involved make it commercially impracticable to do so. If a distribution to creditors is to be made by an administrator, mandatory set-off rules apply under the Rules. These are similar to the set-off rules that apply in a liquidation. Alternatively, distribution may be through a CVA, a scheme of arrangement or a subsequent liquidation.

Expenses

The statutory order of priority of claims in an administration where a distribution to creditors is to be made is fundamentally similar to that in a liquidation (see below). Where an administration involves continued trading (unlike most liquidations) or incurs significant tax liabilities, it is possible that the amounts required to be paid to the administrator during the trading period (administration expenses) and which rank in priority to all claims except those of secured creditors with fixed charges will have a more material impact upon returns to other creditors.

Pre-Pack Administrations

Pre-pack administrations are a popular means of implementing a restructuring that involves the transfer of a business. Pre-packs are often used in cases involving a business with a large number of elements, only some of which are profitable. A pre-pack administration of the company enables a transfer of the profitable elements to a new company (with new funding arrangements) leaving the unprofitable parts of the business in the company in administration. Typically, the details of the transfer of the profitable elements of the business are negotiated immediately prior to the commencement of the administration with the prospective administrator’s involvement. Immediately upon the making of the administration order – in most cases, pursuant to a court order – the administrator effects the transfer, allowing the business to continue in the hands of the purchaser with minimum dislocation. The administrator ordinarily obtains a court order before completing the sale to protect himself from claims that he improperly sold the assets of the company. The rationale for pre-packaged sales is that they allow viable businesses to continue, minimise dislocation to the business because the relevant asset transfers can be effected immediately and preserve value by facilitating a transfer without the associated stigma of insolvency, thereby resulting in greater returns to creditors in the long term.

Restructurings that require the transfer of business assets may use pre-packaged administrations, for example, to allow senior secured creditors to appoint an administrator to effect a transfer that will override the dissent of more junior creditors whose consent would otherwise be required. Directors of the company would be reluctant to effect a sale in such circumstances for fear of later claims for breach of duty.

In such cases the administrator and those planning the pre-pack will want to ensure they are able to justify any sale by having sound valuation evidence in hand, in case a claim by affected parties is made later. Administrators in such cases have to ensure that full
disclosure of the circumstances surrounding the pre-pack sale is made at any creditors’ meeting held later.

In the summer of 2012 the British government announced a review of the existing pre-pack regime. The Insolvency Service commenced a review in July 2013 and their report is expected to be published in Spring 2014.

**Administrative Receivership**

The ability to appoint a receiver is a remedy available to a secured creditor which becomes exercisable (subject to the statutory moratoria in administrations and small company CVAs) when the security becomes enforceable in accordance with its terms. It consequently differs from the other procedures discussed in this Guide in one fundamental aspect. Receivership is not a collective process involving all creditors, but one principally concerned with ensuring the greatest return to the secured creditor.

**Types of Receivership**

The two most common forms of receivership are administrative receivership and fixed-charge receivership (sometimes also called Law of Property Act or LPA receivership). A fixed-charge receiver is one appointed over a specific asset rather than the entirety of the assets of a company, for example, a specific freehold or leasehold property. Nothing more need be said about such receivers, who are most commonly encountered in property finance transactions and whose job is generally to sell the property.

Subject to the conditions set out below, a holder of a floating charge over substantially all of the assets of a company may, on invitation by the directors or default on the loan, be entitled to appoint an administrative receiver to that company. Like an administrator, an administrative receiver has very wide powers to manage a business, deal with employees and dispose of assets. He is usually able to keep the business intact for a period of trading during which he will try to find a buyer for the business as a going concern. Unlike an administrator (who acts in the interests of the creditors generally), an administrative receiver owes his primary duties to the secured creditor who has appointed him. An administrative receiver also owes duties to the preferential creditors insofar as any floating charge asset realisations are concerned, as such creditors have a claim on those assets.

**Who Can Appoint an Administrative Receiver?**

The holder of a floating charge which, together with other security, covers the whole or substantially the whole of a company’s undertaking and was created before 15 September 2003, can appoint an administrative receiver. However, the general rule is that there may not be an administrative receiver appointed under such a floating charge if it was created on or after 15 September 2003 unless the circumstances fall within several restricted sets of circumstances laid down by the Insolvency Acts. These exceptions, set out in section 72A et seq of the Insolvency Act 1986, mainly relate to finance transactions including capital market transactions (e.g., securitizations), project finance, utility finance and finance transactions for social housing. Additionally, some of the exceptions require the relevant transaction under which the security is created to involve a loan of GBP50 million or more. The operation of the exceptions and the question of whether any transaction falls within them can be complex. These restrictions mean that administrations are more common than administrative receiverships outside of the specialised markets mentioned in the exceptions.

Where permitted, appointments of administrative receivers can be made very quickly either once a demand has been made under the relevant loan agreements or once a director has requested chargeholders to appoint an administrative receiver.
Conduct of a Receivership

An administrative receiver has wide powers of management and disposition, can trade the business if necessary to achieve a going concern sale, and can act very quickly. His primary duty is to his appointer, with whom he will liaise in relation to whether any offer for the relevant business is acceptable. Once the receivership is concluded any surplus proceeds in the hands of the receiver will be handed over to a liquidator. Receiverships and liquidations of the same company may run in parallel. In such cases the receiver has control of all of the assets falling within the scope of the security under which he is appointed.

Administrative receiverships have a very restricted role in restructurings aimed at returning a company to financial health. More often than not receivership leads to liquidation. In large groups, strategic appointments of receivers might be made, for example, to a parent company to enable a sale of shares in subsidiaries as part of a restructuring. For the most part, receivership is seen as an enforcement remedy and is too blunt a tool to be used in restructurings. It signals to the outside world that a company or group of companies has defaulted on a loan obligation and so is most likely insolvent. It also crystallises claims by preferential creditors, which have to be dealt with before the receivership ends.

Liquidation

Liquidation is a procedure which results ultimately in the termination of the existence of the company after distribution of its estate to its creditors and, if they are paid in full, a return of capital to the company’s shareholders. It is by far the most commonly encountered formal insolvency procedure in the UK. There are two types of liquidation in England and Wales: voluntary liquidation and compulsory liquidation. They differ mainly in the way they are initiated.

Procedure – Voluntary Liquidation

Voluntary liquidations can be either members’ voluntary liquidations or creditors’ voluntary liquidations. Members’ voluntary liquidations are possible only where all creditors’ claims will be paid in full within 12 months. Creditors’ voluntary liquidations require the company to be insolvent.

To start a members’ voluntary liquidation the shareholders pass a winding-up resolution and nominate a liquidator, who must be a licensed insolvency practitioner. As the company is solvent the directors swear a statutory declaration of solvency, i.e., a formal statement that its liabilities will be paid in full within 12 months. In a members’ voluntary liquidation the expectation is that all creditors will be paid in full so the directors may retain some ability to deal with the company’s assets if the liquidator agrees. This type of liquidation is generally used to restructure solvent companies in a tax-efficient manner and to terminate the life of companies that are no longer needed. It can be used to distribute assets in specie to shareholders under what are termed section 110 agreements.

Where no declaration of solvency can be sworn by the directors of the company because it is insolvent, a creditors’ voluntary liquidation will be used. A shareholder resolution is passed that the company be wound up by reason of its inability to pay its debts and a members’ appointee initially takes office as liquidator. Before any creditors’ meeting is held the nominee has only restricted powers to deal with the assets of the company so as to preserve value. The resolution of the shareholders is the point at which the winding up starts. There must be a meeting of creditors (on the same day or within 14 days) at which the creditors will decide whether to ratify the nomination of the liquidator appointed by the shareholders or whether to appoint somebody else as the liquidator.
Procedure – Compulsory Liquidation

The appointment of a liquidator can also occur as a consequence of the directors, shareholders or a creditor filing a winding-up petition with the court. The petition must state that the company is insolvent or that it is just and equitable that it be wound up, and the petition must be verified by a statement of truth. A creditor whose claim is disputed on bona fide grounds may find its petition to wind up the company is rejected by the court. The petition is served on the company and certain other parties, including anyone who is entitled to appoint an administrator under a qualifying floating charge. The petition is advertised in the London Gazette and heard in court on an appointed date, which may be up to several months after the date it is presented.

Once the petition is presented, those dealing with the company must be careful. This is not just because the petition, once advertised, may damage the creditworthiness of the company with all the consequences that entails. The technical reason lies in the “doctrine of relation back” which is applicable only in the case of a compulsory liquidation. Even though a court makes an order on the winding-up petition some considerable time after the petition was presented (usually some six weeks later), the date on which the petition was presented is the date of the commencement of the compulsory liquidation. Any disposal of the assets of the company after the commencement of the liquidation is void unless validated by the court. Procedures exist for those who deal with companies in this period of hiatus to obtain court sanction for a transaction where it is desirable.

Ranking of Claims

The function of any liquidator appointed will be to agree the extent and validity of creditors’ claims, realise all the assets of the company and distribute dividends to creditors. Where the company is insolvent, claims of creditors rank for dividend pari passu in accordance with the order of priority laid down by the Insolvency Acts. Below is a summary of the order of priority for claims in an insolvent liquidation:

- Holders of fixed charges, who receive all the proceeds of the assets subject to the fixed charges less the costs of realization;
- Expenses of the liquidation;
- Preferential creditors, who (subject to statutory maxima) normally comprise arrears of wages and salary payments to employees;
- Holders of floating charges, who receive the proceeds of the assets subject to the floating charge less agreed costs of the liquidation, the prescribed part fund and preferential creditor claims;
- Unsecured creditors, including any holders of security whose claims were not fully met by the net proceeds of the charged assets; and
- Shareholders, in accordance with their rights inter se.

The liquidator also has various powers to look into suspect transactions entered into by the company during various time windows prior to the commencement of the liquidation. These are discussed in “Clawback and Recovery” below.
Termination of the Liquidation

Once the claims of creditors have been agreed and a final distribution of dividends made, the liquidator may file his final return with the Registrar of Companies in order to effect the company’s dissolution.

Scheme of Arrangement

A scheme of arrangement under the Companies Act is a formal court-sanctioned process that enables a company to implement a compromise or other arrangement between the company and its creditors, one or more classes of creditor, or its shareholders. Schemes of arrangement may be proposed by a company, its shareholders or its creditors outside of any formal insolvency process. If the company is in liquidation or administration the liquidator or administrator must propose any scheme of arrangement. A scheme of arrangement is often used in conjunction with the administration process so that the company enjoys the benefit of the statutory moratorium pending the scheme’s implementation.

Procedure

An initial application to the court must be made for permission to convene meetings of shareholders and creditors. For these purposes, the applicant must identify the classes of creditor and shareholder in the company. Further the applicant must bring to the attention of the court any issues which may arise relating to the constitution, or as may affect the conduct of meetings of those classes. Classes are distinguished by the rights of those within them, which must not be so dissimilar as to make it impossible for them to consult together with a view to their common interest. This involves a comparison of their existing rights as if there were no scheme of arrangement, with the rights which they will have under the scheme. Following the court granting permission to convene meetings, details of the scheme and an explanatory statement are circulated amongst the classes.

For approval, the scheme requires votes to be cast in favour by a majority in number and representing 75% in value of those present and voting (in person or by proxy) in each class. Unlike a CVA, a scheme can bind dissenting secured and preferential creditors so long as the requisite majorities for approval are obtained. If the requisite majorities are obtained in the class meetings then the parties proposing the scheme go back to court for a second hearing to obtain the court’s sanction for the scheme. At the sanction hearing, creditors who object to the scheme have a right to be heard on whether the scheme should be sanctioned. The court will sanction the scheme unless it is established by a party that there has been some procedural irregularity or the scheme is unfair in its treatment of a creditor or class of creditor. The procedure involving court hearings is time-consuming and can be expensive, taking several months to play out.

Effect of Sanction

Once the sanction order of the court is filed with the Companies Registrar the scheme is effective in accordance with its terms. Any dissenting creditors are bound by it. Additionally, any creditor who falls within the scope of the scheme will be bound by it even if he did not receive notice of the scheme and the meetings, provided this was not deliberate on the part of those proposing the scheme. For large, complex debt restructurings the scheme of arrangement has proven itself to be an extremely useful tool over the last several years. The reasons for this are numerous, but include the following:

- A scheme does not necessarily involve a formal declaration of insolvency with the potential to damage the business that entails;
• A scheme is very flexible and can be used in relation to all creditors or just one class of creditor enabling, for example, senior secured creditors to override obstructive junior secured creditors;

• A scheme can provide a tailor-made way to quantify claims that would otherwise prove difficult to value;

• Where there are large numbers of creditors, some of whose identities are not capable of being ascertained, the procedure is flexible enough to bind such creditors and so bring certainty to an otherwise uncertain situation; and

• Schemes can provide not just for the compromise of liabilities but also for the transfer of assets or assumption of liabilities, and this makes it possible to move assets or liabilities into newcos or SPVs as part of an overall scheme to restructure debt.

Careful thought needs to be given to how a restructuring will be implemented where it is necessary to enforce the terms of a scheme of arrangement outside of England and Wales. Some jurisdictions recognise schemes of arrangement under domestic recognition regimes. However, in many jurisdictions, including other EU member states, there is doubt as to whether schemes of arrangement can be recognised in the same way that a judgment of the English court can be recognised.

Overseas Companies

A growing body of case law has established that non-UK-registered companies can take advantage of the scheme of arrangement mechanism to restructure their affairs, provided there is some connection with England and Wales which allows the court to assume jurisdiction. Having assets within the jurisdiction or creditors whose debt is governed by English law will help satisfy the criteria for the court taking jurisdiction over a scheme proposed by a non-UK company.

Clawback and Recovery

The Insolvency Act provide liquidators and administrators with a number of powers to review transactions which have been entered into before the inception of the insolvency with a view to clawing back assets into the estate of the debtor for the benefit of creditors generally. Any party dealing with a company in the run-up to its insolvency or potential insolvency needs to consider the possibility that any transaction may be scrutinised by any appointed insolvency office-holder.

Transactions at Undervalue

In order for a successful challenge to be made, the administrator or liquidator, under section 238 of the Insolvency Act 1986, needs to satisfy the court that the insolvent entity:

• Was either insolvent at the time of the transaction or rendered insolvent by it;

• Made a gift to a person or otherwise entered into a transaction with a person on terms that provide for it to receive no consideration or entered into a transaction for a consideration the value of which, in money or money’s worth, is significantly less than the value, in money or money’s worth, of the consideration provided by the company; and

• The transaction was entered into within a period of two years prior to the commencement of insolvency proceedings.
If successful, the court can make an order to restore the position to what it would have been if the transaction had not been entered into.

A court cannot make an order if the transaction was entered into in good faith by the company for the purpose of carrying on its business and at the time there were reasonable grounds for believing the transaction would benefit the company.

Preferences

Under section 239 of the Insolvency Act 1986, a company gives a preference to a person if it enters into a transaction with a person (at a time when it is insolvent or becomes insolvent as a result of the transaction) and:

- That person is one of the company’s creditors or a surety or guarantor for any of the company’s debts; and
- The company does or suffers to be done anything which has the effect of putting that person in a better position, in the event of the company going into insolvent liquidation, than it would otherwise have been in.

A transaction is not a preference unless the company making the preference is motivated by a desire to prefer the recipient. This can give rise to difficult evidential problems for those involved in litigation relating to preferences.

Under the preference regime a liquidator may look back at transactions which took place within a period of six months prior to the appointment of an insolvency office-holder if entered into with an unconnected party, and two years if entered into with a connected party (other than an employee). “Connected party” is widely defined to capture most types of associates.

If the challenge is successful, the court may make such order as it deems fit in order to restore the position to what it would have been if the preference had not been given.

Floating charges

Under section 245 of the Insolvency Act 1986, a floating charge which is created in the year prior to the onset of insolvency (or the two years prior to the onset of insolvency where connected persons are involved) may be vulnerable to attack save to the extent new money or value was provided at the time or after the floating charge was created.

There are a number of other provisions under English law that deal with attempts by companies to defraud creditors and which provide remedies to victims.

Personal Liability of Directors

There are a number of provisions under the Insolvency Acts which provide for directors and shadow directors (i.e., those not formally appointed but pursuant to whose instructions the board acts) to be personally liable to contribute to the estate of the insolvent company where they are deemed not to have taken steps to minimise the damage done to creditors.

Note, however, that there are no rules relating to time limits within which a director who is aware of impending insolvency must file to initiate formal insolvency proceedings as in some other jurisdictions.
Wrongful Trading

This applies where a company goes into liquidation. The liquidator may apply to court for an order making a director liable to contribute personally to the company’s assets if, at some time before the start of winding up the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation and that person was a director (actual, de facto or shadow) of the company at that time. Any order requiring a director to contribute will be of a contributory as opposed to penal nature and should reflect the degree to which the period of wrongful trading either depleted the assets or increased the liabilities of the company.

There is a defence to wrongful trading proceedings where the director can satisfy the court that he took every possible step to minimise the potential loss to the company’s creditors.

For the purposes of the Insolvency Act 1986, the facts which a company director ought to know or ascertain, the conclusions he ought to reach and the steps he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both:

- The general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company; and
- The general knowledge, skill and experience that that director has.

Directors whose companies are in financial difficulties will need to hold regular board meetings to consider the company’s financial prospects and their reasons for any decision to continue trading.

Fraudulent Trading

Where the directors carry on a company’s business with the intent to defraud creditors of the company or any other person, or for any fraudulent purpose, the court may on the application of the liquidator, declare that any persons who were knowingly party to carrying on the business in such a way will be liable to contribute to the company’s assets as the court thinks fit.

The distinction between fraudulent trading and wrongful trading is that fraudulent trading involves dishonest intent. Fraudulent trading is a criminal offence.

Statutory Misfeasance

Where a director is found to have abused his position as trustee of the company’s assets and has misapplied them in any way, the provisions of section 212 of the Insolvency Act 1986 allow a liquidator to pursue the director for restoration of the company’s property, payment of the money involved or compensation.

Reports on Directors

Insolvency office-holders will write a report on the conduct of directors of insolvent companies. Where the report shows evidence of misconduct or breach of duty, the Secretary of State (not the office-holder) may take proceedings against that director with a view to disqualifying the director from being involved in the management of a company for the future.
Consensual Restructuring Agreements

Frequently, before resorting to formal insolvency proceedings, an insolvent company will try to enter into contractual compromise or standstill arrangements with its creditors, usually involving debt repayment or deferral. The advantages of a reaching a consensual agreement with creditors include avoiding the stigma and asset-value erosion of formal insolvency proceedings and the risk of losing all assets or having an ongoing business shut down. Consensual restructurings may also avoid triggering default provisions in contracts which are crucial to the continued viability of the business of the company.

Such consensual restructuring agreements, both temporary as in the case of standstill agreements, and permanent in the case of rescheduling agreements, are recognised under English law. Restructuring practice in England and Wales has developed numerous flexible responses to large, complex debt rescheduling involving parties in multiple jurisdictions.

Conclusions and Additional Observations

Some general observations can be made about insolvency and restructuring law and practice in England and Wales:

- The support of a company’s major creditors is necessary if a company is to attempt a consensual restructuring. Key bank and any trade creditors with material amounts outstanding, whose debt will not be paid on time in full, need to be brought into the group of creditors who participate in any restructuring;

- Standstill arrangements can be put in place on a consensual basis, and such agreements will be recognized and enforced by the English courts. Where this is not possible but remains necessary, the moratorium imposed under the administration process may achieve the necessary breathing space for a company to implement a restructuring, although this involves an admission of insolvency which will be public information and a loss of control of management of the business to the administrator;

- The English courts are receptive to non-UK-based companies who wish to use the processes outlined above to assist in any restructuring. The threshold criteria that must be satisfied to engage jurisdiction are considered relatively easy to meet, particularly where assets or major creditors are present within the jurisdiction or credit agreements are governed by English law as is often the case where Loan Market Association documents are used for loan agreements; and

- The cross-border aspects of English insolvency law relating to recognition of other states’ insolvency office-holders are well developed. For EU-based insolvency practitioners (except those in Denmark) appointed in collective proceedings in their home state, recognition is automatic under the EU Insolvency Regulation. For non-EU states the UK has implemented the UNCITRAL Model Law on Cross-Border Insolvency fully pursuant to domestic regulations passed in 2006.
European Union

Overview and Introduction

The term “European insolvency law” may either refer to the sum of the insolvency laws of the EU’s member states (as adopted by the respective national legislative bodies, and including such laws to implement European insolvency law directives) or refer to the insolvency laws adopted by the EU itself being directly effective in the member states without any implementation. European insolvency law in the latter sense will be dealt with in this chapter.

European insolvency law determines conflict-of-law issues, such as international jurisdiction, recognition and applicable law, and modifies applicable local law in cross-border cases. Therefore, although European insolvency law provides neither for a comprehensive insolvency regime (in the sense of harmonising all member state laws) for insolvencies of European groups of companies, nor for European cross-border insolvencies in general, it must inevitably be taken into account when dealing with insolvencies in Europe.

Applicable Legislation

At the beginning of the European unification process, cross-border insolvencies were governed by the international insolvency laws of the member states – as modified by bilateral treaties – only. It soon became clear that there was a need to establish common rules governing cross-border insolvencies. However, it took several decades to agree on such rules.


The EU Insolvency Regulation entered into force on 31 May 2002. As a regulation, it does not need to be implemented by the member states but has to be directly applied by national courts. Both the EU Insurance Undertakings Directive and the EU Credit Institutions Directive had to be implemented by the member states, and all member states covered by this Guide have implemented both directives and amended their national laws accordingly. Note, however, that the Regulation does not apply in Denmark.

There have been a number of amendments to the annexes of the Regulation to address the addition of new member states and update references to national insolvency law. The consolidated text of the amended annexes can be found in Council Regulation (EC) No 583/2011 of 9 June 2011.

At the time of writing a European proposal to update the Regulation is being considered. The changes proposed are relatively substantial in nature and include:

• Broadening the scope of the Regulation to catch arrangements designed to avoid entering formal insolvency proceedings;
• Moving the definition of “center of main interests” to the body of the legislation from the recitals;

• Allowing secondary proceedings to take the form of whichever national insolvency proceeding is most appropriate; and

• Adding new provisions for the co-ordination of insolvency proceedings relating to groups of companies.

• The current draft anticipates a two-year delay between publication of the amended Regulation in the Official Journal and the new provisions taking effect.

Scope of Applicability

The EU Insolvency Regulation applies to collective insolvency proceedings involving the (partial or total) divestment of a debtor and the appointment of an insolvency office-holder whose function is to manage the debtor’s estate for the benefit of all creditors in collective proceedings. The proceedings to which the regulation applies are conclusively listed in annexes to the Regulation. The Regulation does not apply to insolvency proceedings concerning insurance undertakings, credit institutions and certain investment undertakings.

The EU Insolvency Regulation applies in all member states (except Denmark), provided that the centre of the debtor’s main interests is situated in the territory of a member state and the insolvency proceedings are of a cross-border nature. The latter is true, for example, if: assets of the insolvency estate are situated in several member states; the debtor has entered into contracts with contractual partners domiciled in other member states; or creditors of the debtor are domiciled in other member states. Whether the cross-border nature may also be established by a relation to non-member states is still disputed. So far, UK courts in particular tend to take the position that this is sufficient; the European Court of Justice has not yet decided on this matter.

Note that if a debtor’s place of incorporation is outside of the territory of the member states but its centre of main interests is determined to be within such territory, the Regulation will apply to that insolvency, for example, for the purposes of determining jurisdiction to open proceedings and the recognition of its insolvency office-holders within the EU.

International Jurisdiction and Recognition

The courts of that member state within the territory of which the centre of a debtor’s main interests is situated have jurisdiction to open insolvency proceedings. The competent court within the courts of a member state so having jurisdiction is determined according to national law.

Centre of Main Interests

Under the European Insolvency Regulation, the location of the centre of the debtor’s main interests (“COMI”) is the decisive criterion for determining international jurisdiction and applicable insolvency law. Any debtor has one COMI only.

In the case of companies or entities, the place of the registered office is presumed to be the COMI in the absence of a proof to the contrary. In cases of doubt, the insolvency court has to investigate independently whether this legal presumption is rebutted.

Given the importance of the COMI for the entire insolvency proceedings on the one hand, and the abstract description of the COMI on the other hand, it is unsurprising that a substantial case law on COMI issues has developed. Initially, some courts decided that the
COMI was at the place of the debtor’s head office functions or strategic management (mind of management theory); other courts determined the COMI as the place of the debtor’s main business activity (business activity theory).

On 2 May 2006, the European Court of Justice rendered a landmark decision (Case C-341/04, Eurofood IFSC Ltd) and decided that the presumption of the COMI can be rebutted only based on factors which are both objective and ascertainable by third parties. That could be so in particular in the case of a company not carrying out any business in the territory of the member state in which its registered office is situated. By contrast, where a company carried on its business in the territory of the member state where its registered office is situated, the mere fact that its economic choices were controlled by a parent company in another member state was not enough to rebut the presumption.

The principles of the Eurofood case were upheld by the European Court of Justice and further guidance was given on the factors national courts should consider when applying the Eurofood principles in Interedil Srl (in liquidation) v Fallimento Interedil Srl & another [2011] EUECJ C-396/09.

The Eurofood decision is considered a strong affirmation of the business activity theory. However, at the same time, the decision does not mean the final end of the mind of management theory; its criteria (place of head office functions or strategic management) may still apply supportively. In practice, important factors to determine the COMI are:

- Location of the debtor’s business premises, productions sites and warehouses;
- Place of work of the debtor’s employees;
- Location of the debtor’s bank accounts used for payments to creditors;
- Choice of law in contracts with creditors.

In most cases, determining a debtor’s COMI is not difficult. However, in cases of doubt, particularly if the COMI is used as a migration tool for forum shopping (see below), the correct determination of the COMI may be more difficult and – at the same time – a crucial issue for the entire insolvency proceedings and restructuring efforts.

European insolvency law does not provide for a proper insolvency regime for groups of companies, and this has been the cause of much criticism of the Regulation: the insolvency of each group company is determined on an individual basis, i.e. regardless of such company forming part of an overall insolvent group. Moreover, the COMI of each group company is determined separately. As a consequence, group insolvencies may trigger numerous insolvency proceedings in numerous jurisdictions. Prior to the Eurofood decision of the European Court of Justice, several European courts decided in favor of a common COMI for insolvent groups of companies, arguing – based on the mind of management theory – that the group’s head office functions and strategic management were concentrated at one place. After the Eurofood decision such argument no longer prevails. Nevertheless, practice shows that attempts to establish a common COMI in group insolvency scenarios can be successful where this is desirable to preserve value for creditors. Useful tools are, for example, concentrating all important group functions at the desired COMI, handling the entire group’s communication from that desired COMI, and establishing a restructuring board at the desired COMI which plans, negotiates and implements restructuring measures for and on behalf of the entire group (cf.: Tribunal de commerce Paris, 2 August 2006, 2006047554, Dalloz 2006, 2329 – “Eurotunnel”; Local Court of Cologne, 19 February 2008, 73 IE 1/08 – “PIN-Holding”).
The COMI of self-employed business people, merchants, manufacturers, tradesmen, etc. is usually at their offices or manufacturing sites; the COMI of consumers is usually at their residences.

Using the COMI as a Migration Tool

Since the COMI is the decisive criterion for determining international jurisdiction and applicable insolvency law, it is sometimes worth considering a shift of the COMI prior to filing for insolvency to take advantage of the most beneficial insolvency regime or to better coordinate group restructurings ("forum shopping"). Conversely, creditors might wish to seek contractual protection against a COMI shift of their debtors. In any case, one should not forget that a COMI shift is time-consuming, costly and burdensome and needs to be planned well in advance. The pros and cons of a shift have to be weighed up carefully, and the insolvency laws involved need to be analysed thoroughly, before taking a decision.

Recognition of Insolvency Proceedings

With respect to one and the same insolvent debtor, European insolvency law permits the opening of main insolvency proceedings only once (for additional territorial proceedings, see below). Any judgment by a court of a member state ordering opening of insolvency proceedings has to be recognised in all the other member states, even if the opening court erroneously assumed jurisdiction, unless recognition would be manifestly contrary to a member state's public policy. In principle (for exceptions, see “Applicable Law” and “Territorial Proceedings” below), as a consequence of such recognition:

- The judgment opening the proceedings produces, with no further formalities, the same effects in any other member state as under the law of the state of the opening of proceedings and applies to all assets of the debtor in all member states;
- The liquidator appointed by the court may exercise in all other member states all the powers conferred on him by the law of the state of the opening of proceedings;
- Judgments rendered by the court concerning the course and closure of the proceedings, compositions approved by that court, and judgments deriving directly from, and closely linked with, the insolvency proceedings are recognized with no further formalities; and
- The jurisdiction of the opening court may be challenged only as provided for under national procedural law.

Applicable Law

Basic Principle

As a basic principle (for exceptions, see “Exceptions” and “Parallel Proceedings” below), the law applicable to the insolvency proceedings and their effects is that of the member state within the territory of which the proceedings are opened (state of the opening of proceedings). That law determines the conditions for the opening of the proceedings, their conduct and their closure, including, inter alia:

- Against which debtors insolvency proceedings may be brought;
- The assets which form part of the insolvent estate;
- The powers of the liquidator and restrictions imposed on the powers of the debtor;
• The conditions under which set-offs may be invoked;
• The effects of the insolvency proceedings on pending contracts to which the debtor is party;
• The effects of the insolvency proceedings on proceedings brought by individual creditors (with the exception of pending lawsuits);
• The rules governing the lodging, verification and admission of claims;
• The rules governing the distribution of proceeds from the realization of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set-off;
• The conditions for, and the effects of, closure of insolvency proceedings, in particular by composition;
• Creditors’ rights after the closure of insolvency proceedings;
• Allocation of the costs and expenses incurred in the insolvency proceedings; and
• The rules relating to the invalidity, voidability or unenforceability of legal acts detrimental to the community of creditors.

Exceptions

However, the basic principle described above is subject to numerous important exceptions to protect legitimate expectations and the certainty of transactions in member states other than the state of the opening of proceedings:

• The opening of insolvency proceedings does not affect the rights in rem of creditors or third parties in respect to assets belonging to the debtor which are situated within the territory of another member state at the time of the opening of proceedings. The term “assets” includes all kind of tangible, intangible, moveable or immovable assets, and both specific assets and collections of indefinite assets as a whole which change from time to time as, for example, in case of a floating charge under UK law. Though such rights in rem may not be affected by the opening of the proceedings, they may well be affected later in the course of the proceedings, for example, by a rescue plan or a composition;
• Creditors may still demand the set-off of their claims against the claims of the debtor, provided that such a set-off is permitted by the law applicable to the debtor's claim;
• Insolvency proceedings against the purchaser of an asset do not affect the seller's rights based on a reservation of title, and, vice versa, insolvency proceedings against the seller of an asset, after delivery of the asset, do not constitute grounds for rescinding or terminating the sale and do not prevent the purchaser from acquiring title, provided that, in each case, the asset is situated within the territory of another member state at the time of the opening of proceedings;
• The effects of insolvency proceedings on contracts conferring the right to acquire or make use of immovable property are governed solely by the insolvency law of the member state within the territory of which the immovable property is situated;
The effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market are governed solely by the insolvency law of the member state applicable to that system or market;

The effects of insolvency proceedings on employment contracts and relationships are governed solely by the insolvency law of the member state applicable to the employment contract;

The effects of insolvency proceedings on the debtor's rights in immovable property, a ship or an aircraft registered in a public register are determined by the law of the member state under the authority of which the register is kept;

Persons benefitting from an act detrimental to all the creditors may defend themselves against a challenge to the relevant act by proving that the act in question is subject to the law of a member state other than that of the state of the opening of proceedings (e.g. due to a contractual choice of law) and that under the applicable law the act is valid and cannot be challenged or avoided in any way; to a certain extent, this exception may help to protect transactions against potential clawback actions triggered by an insolvency where clawback regimes allow for different defences to a claim;

If – after the opening of insolvency proceedings – the debtor disposes, for consideration, of: immovable assets; ships or aircrafts registered in public registers; or securities whose existence presupposes registration in a register, the validity of that disposal is governed by the insolvency law of the member state within the territory of which the immovable asset is situated or under the authority of which the register is kept;

The effects of insolvency proceedings on a pending lawsuit concerning an asset or right of which the debtor has been divested are governed solely by the law of the member state in which that lawsuit is pending.

Parallel Proceedings

Overview

In addition to the insolvency proceedings that may be opened by the courts of the member state within the territory of which the debtor's COMI is situated ("main proceedings"), the EU Insolvency Regulation provides for two types of parallel proceedings:

- Secondary proceedings, i.e., winding-up proceedings opened by the courts of a member state after main proceedings have been opened by the courts of another member state; and

- Territorial insolvency proceedings opened by the courts of a member state prior to the opening of main proceedings by the courts of another member state.

Parallel proceedings may be opened only by courts of a member state within the territory of which the debtor possesses an establishment, i.e., has a place of operations where the debtor carries out a non-transitory economic activity with human means and goods. The mere fact that some of the debtor's assets are situated in a member state does not constitute an establishment in that member state.

Parallel proceedings are governed by the insolvency laws of the member state in which the parallel proceedings are opened. These laws apply to the same extent (and with the same
exceptions) they would apply if main proceedings were opened in that member state (see above). The effects of parallel proceedings in a member state are restricted to the assets of the debtor situated in that member state at the time at which the judgment opening proceedings becomes effective.

Secondary Proceedings

Secondary proceedings, i.e. parallel proceedings opened by the courts of a member state after main proceedings have been opened by the courts of another member state, are always winding-up proceedings. Secondary proceedings may be opened upon request by:

- The liquidator in the main proceedings; or
- Any other person or authority empowered to request the opening of insolvency proceedings under the law of the member state of the secondary proceedings.

The courts opening the secondary proceedings do not examine whether the debtor – under the insolvency law applicable to the secondary proceedings – would be insolvent; the mere opening of the main proceedings justifies the opening of the secondary proceedings.

The liquidator in the main proceedings and the liquidators in all secondary proceedings are obliged to properly inform each other about the proceedings and cooperate with each other. The liquidators shall lodge in other proceedings claims which have already been lodged in proceedings for which they were appointed, provided that the interests of the creditors in the latter proceedings are served thereby, subject to the right of creditors to oppose the lodgment or to withdraw the lodgment of their claims where the applicable law so provides. Moreover, the liquidators are empowered to participate in the other proceedings as if they were a creditor, in particular by attending creditors’ meetings. They are also entitled to inspect the files of the respective insolvency courts; however – though still subject to confirmation by the courts – they do not have any voting rights.

In addition, the liquidator in the main insolvency proceedings may:

- Submit proposals to liquidators in the secondary proceedings on the liquidation or use of the assets in the secondary proceedings;
- Request the court that opened the secondary proceedings to stay the process of liquidation in secondary proceedings, provided that in that event the court may require the liquidator in the main proceedings to guarantee the interests of the creditors in the secondary proceedings;
- Propose that the secondary proceedings be closed, without liquidation, by a rescue plan, composition or comparable measure where the law applicable to the secondary proceedings allows for such closure, or object to such measure, unless the financial interests of the creditors in the main proceedings are not affected by the proposed measure.

If by the liquidation of assets in the secondary proceedings all claims allowed under those proceedings have been satisfied, the liquidator in the secondary proceedings has to transfer any assets remaining to the liquidator in the main proceedings.
Territorial Proceedings

Territorial proceedings, i.e. parallel proceedings opened by the courts of a member state prior to the opening of main proceedings by the courts of another member state, may be opened only:

- Where main proceedings cannot be opened because of the conditions of the law of the member state where the debtor’s COMI is situated; or
- Upon request by a creditor who has his domicile, habitual residence or registered office in the member state in which the debtor’s establishment is situated, or whose claim arises from the operation of that establishment.

To open territorial proceedings the opening court has to examine whether the debtor – under the insolvency law applicable to the territorial proceedings – is in fact insolvent. Territorial proceedings may be opened either as winding-up proceedings or as proceedings aiming at the restructuring of the debtor.

If after the opening of territorial proceedings main proceedings are opened in the member state in which the debtor’s COMI is situated, the territorial proceedings turn into secondary proceedings and the associated principles (see “Secondary Proceedings” above) apply insofar as the progress of the territorial proceedings permits. In such case, the liquidator in the main proceedings may request that territorial proceedings which have been opened as restructuring proceedings be converted into winding-up proceedings if this proves to be in the interests of the creditors in the main proceedings.

Provision of Information and Lodgment of Claims

With regard to the provision of information and the lodgment of claims, the EU Insolvency Regulation differentiates between creditors residing in member states other than the state of the opening of proceedings (EC creditors) and creditors residing in the state of the opening of proceedings (local creditors) or third countries (third country creditors):

- As soon as main or parallel proceedings are opened in a member state, the competent court or the liquidator appointed by it has to immediately inform known EC creditors by individual written notice;

- EC creditors have to lodge their claims in the main proceedings and in all territorial proceedings in writing, but are entitled to use their local language. Any lodgment must include copies of supporting documents, if any, and indicate the nature of the claim, the date on which it arose and its amount, as well as whether the creditor claims preference, security in rem or a reservation of title in respect of the claim and what assets are covered by the guarantee he is invoking. Further details of the lodging (lodging periods, consequences of missing them, costs, verification, admission and ranking of lodged claims, etc.) are governed by the national insolvency law applicable;

- Local creditors and third country creditors have to be informed and may lodge their claims in accordance with the national insolvency law applicable.

- In addition, liquidators lodge claims which have already been lodged in proceedings for which they were appointed (see “Secondary Proceedings” above). It is not yet clear, however, whether the liquidators are legally obligated to lodge such claims and may be held liable if they fail to do so.
Dividend Distribution and Creditor Strategy

The insolvency of a debtor may trigger several insolvency proceedings (main proceedings in one member state and parallel proceedings in other member states). Dividends may be distributed both in the main proceedings and in the parallel proceedings, in each case in compliance with the respective applicable national insolvency law. Creditors do not necessarily participate in all of the proceedings and dividends distributed may vary. Nevertheless, one basic principle of the EU Insolvency Regulation is equal treatment of creditors (*par conditio creditorum*). The Regulation seeks to achieve such equal treatment by way of dividend imputation.

Distribution Rules

Dividends are distributed in accordance with the following rules:

- No creditor is entitled to receive distributions of an amount exceeding the amount of his claim;
- Any creditor is entitled to lodge the entire amount of his claim in the main proceedings and in all parallel proceedings, irrespective of any dividends already obtained. If, for example, a creditor has a claim of EUR 100,000 and the liquidator of parallel proceedings has distributed to that creditor a dividend of EUR 10,000, the creditor may still lodge a claim of EUR 100,000 in the main proceedings. Whether the same is true if a creditor has not obtained a dividend but a partial satisfaction of his claim by way of security enforcement depends on the applicable national insolvency law;
- The ranking of claims is solely governed by the national insolvency law applicable to the respective (main or parallel) proceedings;
- A creditor who has, in the course of insolvency proceedings, obtained a dividend on his claim shares in distributions made in other proceedings only where creditors of the same ranking have, in those other proceedings, obtained an equivalent dividend (imputation). Dividends lawfully obtained do not need to be repaid.

It should be noted that these rules do not apply to the claims of creditors resident in non-member states. The treatment of those claims is solely governed by the applicable national insolvency law (i.e. by such national law’s international insolvency provisions as modified by bilateral treaties).

Example

A (simplified) example may illustrate these rules:

The debtor has its COMI in Spain and an establishment in Germany. Main proceedings have been opened in Spain; secondary proceedings in Germany. The debtor has two creditors only: Creditor A and Creditor B. Both have unsecured, equally ranking claims of EUR 100,000. Creditor A has lodged his claims in both proceedings. Creditor B has lodged his claims in the main proceedings only.

(a) The distributable funds amount to EUR 90,000 (main proceedings in Spain) and EUR 50,000 (secondary proceedings in Germany). In such case, dividends are distributed as follows:

- Secondary proceedings in Germany: as sole creditor having lodged claims, Creditor A obtains a dividend of EUR 50,000 (equalling 50% of Creditor A’s...
claims). Creditor B has not lodged his claims in Germany and does not obtain any dividend.

- Main proceedings in Spain: Creditor B is entitled to a pre-dividend equivalent to the dividend obtained by Creditor A in the secondary proceedings in Germany (50%, i.e. EUR 50,000). The remainder of the distributable funds (EUR 40,000) is distributed to the creditors proportionally (in accordance with the nominal amounts of the lodged claims). Hence, Creditor B obtains an overall dividend of EUR 70,000 (equalling 70% of Creditor B’s claims), and Creditor A obtains a dividend of EUR 20,000 (equalling 20%, and, together with the dividend obtained by Creditor A in Germany, 70% of Creditor A’s claims).

This example demonstrates the equal treatment of the creditors. In the end, both creditors obtain dividends equalling 70% of their lodged claims. However, this is not always the case.

(b) If, in the above example, the distributable funds amount to EUR 50,000 (main proceedings in Spain) and EUR 90,000 (secondary proceedings in Germany), dividends are distributed as follows:

- Secondary proceedings in Germany: As sole creditor having lodged claims, Creditor A obtains a dividend of EUR 90,000 (equalling 90% of Creditor A’s claims). Creditor B has not lodged his claims in Germany and does not obtain any dividend.

- Main proceedings in Spain: Creditor B is entitled to a pre-dividend equivalent to the dividend obtained by Creditor A in the secondary proceedings in Germany (90%, i.e. EUR 90,000). Since the funds distributable in the main proceedings amount to EUR 50,000 only, the entire funds (equalling 50% of Creditor B’s claims) are distributed to Creditor B. Though Creditor A has lodged his claims, he does not obtain any dividends.

This variation of the example demonstrates that the creditors may not always be treated equally. Though Creditor A’s claims have been satisfied by 90% and Creditor B’s claims by 50% only, Creditor A is not obligated to repay any of the funds lawfully received as dividend in the secondary proceedings in Germany.

**Creditor Strategy**

Such unequal treatment may occur if creditors (and the liquidators) do not lodge their claims in those proceedings in which the highest dividends may be obtained. Similarly, creditors may be treated unequally if creditors (and the liquidators) fail to initiate, or lodge their claims in, proceedings in which their claims would have obtained a preferred ranking.

It is not yet clear whether: the liquidators are legally obligated to lodge in all other proceedings which were lodged in their own proceedings, and the liquidators may be held liable if they fail to do so (see “Secondary Proceedings” above). As a consequence:

- Creditors should not rely on a lodgment by the liquidators. Instead, they should always make sure to lodge their claims in the main proceedings and all parallel proceedings in which substantial dividend distributions may be expected; and

- Creditors should always check whether they may successfully apply for the opening of secondary proceedings in jurisdictions in which their claims would obtain a preferred ranking.
Conclusions and Additional Observations

Though the EU has common rules governing European cross-border insolvencies, a substantive common insolvency law does not yet exist. Nevertheless, European insolvency law deals with important conflict-of-law issues such as international jurisdiction, recognition and applicable law. Therefore, it has always to be taken into account both by debtors and creditors in cross-border insolvencies or restructurings if European member states are involved.
Overview and Introduction

France has two separate regimes operating in respect of the insolvency of an individual and a corporation.

The main objective of these regimes is to “save” the debtor in financial difficulties by offering several ways to renegotiate its debts with its creditors as soon as possible.

Applicable Legislation

French Bankruptcy Law is codified as follows:

- The personal insolvency regime is governed by articles L330-1 of the French Consumer Code;
- The corporate insolvency regime is governed by Book VI of the Commercial Code\(^1\) (Des Entreprises en Difficultés). Several laws and orders have modified this regime; primary recent legislation is dated 26 July 2005,\(^2\) 18 December 2008, 22 October 2010 and 12 March 2014.

Personal Over-Indebtedness

The procedure of processing a situation of over-indebtedness was reformed for the fifth time in 2010. The objective of the law is to avoid excessive debts of the private individual by establishing a faster and more efficient procedure.

Type of Debtor Concerned

The over-indebtedness procedure is available to natural persons who are well-intentioned and facing “the manifest impossibility” of meeting “either all of his personal debts due now and in the future or fulfilling an undertaking he has given to guarantee or jointly and severally settle the debt of an individual contractor or a company when he was not a de facto or de jure executive thereof”.

Steps of the Proceeding

The debtor may file a petition before the commission of over-indebtedness in order to obtain the suspension of execution’s procedures against his assets.

The debtor delivers the file and reveals his assets and details of his holdings to the commission.

The commission will then start a preliminary investigation and hearings. The commission rules on the case’s admissibility within three months.

If the petition is granted, the automatic suspension of the creditors’ rights of recourse and the interruption of the debtor’s payments for a maximum one year is declared.

A mission of conciliation is implemented by the elaboration of a conventional plan of recovery approved by the debtor and his main creditors. The debt rescheduling measures provided for in the plan cannot exceed eight years.

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2. Loi de Sauvegarde des Entreprises.
If the mission of conciliation fails, at the debtor’s request the commission can impose either ordinary measures (e.g. a rescheduling of the payment of debts of all kinds) or extraordinary measures (e.g. the suspension of the obligation to pay the debts).

If, while executing the plan or the measures imposed by the commission, the situation of the debtor becomes irremediably compromised, the commission may recommend:

- A measure of relief from debts without liquidation;
- A measure of relief from debts with liquidation, if the debtor has sufficient assets.

Both cases lead to the suspension of the rights of recourse for actions made against the debtor, and eventually to the total erasing of its non-professional debts.

**Corporate Insolvency**

**Types of Procedure**

A company that faces financial difficulties may be placed into the following procedures:

- *Ad hoc* mandate;
- Conciliation;
- Safeguard;
- Accelerated financial safeguard;
- Accelerated safeguard;
- Reorganisation;
- Liquidation.

The first five procedures mainly concern companies that are not in cessation of payments (*cessation des paiements*) (or, in conciliation cases, if it has suspended its payments for less than 45 days). A company is in cessation of payments when it is not able to pay its debts with its available assets.

The last two procedures apply to companies in cessation of payments. The liquidation of the company is a terminal procedure ordered when the company has no chance of recovery.

**Ad Hoc Mandate**

The *ad hoc* mandate (*mandat ad hoc*) is an attempt to prevent bankruptcy whereby an *ad hoc* representative is appointed by the President of the Commercial Court to devise possible solutions to the debtor’s financial problems.

Only the legal representative of the company can request the opening of such proceedings. The legal representative files a petition before the President of the Commercial Court.

Usually, the *ad hoc* representative is chosen from the official list of judicial administrators.

The appointment of an *ad hoc* representative has no binding effect on third parties or participants. There is no stay of legal proceedings, and the effects of any negotiated settlement are purely contractual in nature.
The assignment can be quite varied, ranging from solving a single problem to providing a wide array of assistance and support.

The representative can also conduct negotiations or mediation for the purpose of restructuring the company.

Such a procedure is strictly confidential.

**Conciliation Proceeding**

Any company that is facing actual or foreseeable difficulties can apply to the President of the Commercial Court to request the opening of a conciliation proceeding. The company may even request the opening of a conciliation proceeding if it is already in cessation of payments, provided that it has suspended its payments for less than 45 days. Only the legal representative of the company can request the opening of such proceedings.

The President of the Commercial Court appoints a conciliator, who is usually chosen from the official list of judicial administrators, for a maximum of four months. (This period can be exceptionally extended, provided that the whole conciliation period does not exceed five months.)

The conciliator’s assignment is to try to resolve the financial difficulties of the debtor by seeking an agreement between the debtor and its main creditors. Such an agreement usually provides the payment of debts in several instalments and/or the abandonment of part of the debts.

Conciliation is a purely contractual proceeding between the debtor and its creditors. There is no stay of claims or legal actions for payment.

The payment plan, agreed between the debtor and its creditors, may be:

- Recorded (*constaté*) by the President of the Court (in this case, it remains confidential); or
- Approved (*homologué*) by the court provided that: the debtor is not in cessation of payments; the agreement allows the durability of the business to be ensured; and the agreement does not harm the creditors who are not party to it.

In the latter case, if, at a later date, the debtor is placed under reorganisation (*redressement judiciaire*) or liquidation (*liquidation judiciaire*) proceedings, the court cannot determine the date of cessation of payments to be earlier than the time of the approval of the agreement.

Furthermore, companies which provided new cash to the debtor under the agreement are privileged in case of further reorganisation or liquidation proceedings (*privilege de l’argent frais*). As they are given priority in repayment, the debtor will have an easier time convincing the creditors to participate in the financial restructuring of the company.

The judgment approving the agreement is published. In such a case, the agreement will not be confidential.

The advantage of conciliation for an insolvent company is that it provides invaluable help in avoiding bankruptcy.

**Safeguard Proceeding and Reorganisation Proceeding**

The safeguard and the reorganisation proceedings both allow a company to reorganize its outstanding debts and continue to operate its business while a draft plan of safeguard or
plan of reorganisation is being established. The safeguard and reorganisation proceedings engender highly similar effects (see below). The respective requirements to open the proceedings are, however, to be distinguished.

A safeguard proceeding (sauvegarde) can be started only at the request of the company’s legal representative upon justification that the company has difficulties that it cannot overcome. Therefore, the company’s legal representative is not entitled to file a petition for safeguard proceedings if the company is already in cessation of payments.

A reorganisation proceeding (redressement judiciaire) must be initiated when the company is already in cessation of payments. There are two main ways of initiating reorganisation proceedings:

• Voluntary filing: the company’s legal representative must petition the court to open reorganisation proceedings within 45 days from the date on which the company became unable to pay its debts as they become due; or

• Third party filing: any unpaid creditor may request the opening of reorganisation proceedings.

Observation Period

The opening judgment initiates the commencement of a six-month observation period, which may be extended once by the court for an additional six-month period.

During the observation period, the company’s financial, economic and employment situation is assessed and a proposed rescue plan is drafted.

Debts incurred during the observation period for the purposes of the business are paid as they mature and upon liquidation or transfer of all the assets in preference over all other claims, including certain privileged or secured claims, with the exception of privileged labour claims.

Role of the Administrator and the Creditors’ Representative

The creditors’ representative (mandataire judiciaire) and the administrator(s) are appointed by the court in the opening judgment.

The creditors’ representative represents all creditors (except employees) in the proceeding.

The judicial administrator’s role is to evaluate the economic and financial situation of the company, to supervise or assist (mission de surveillance ou d’assistance) the managers of the company who remain in charge of the management of the company, and to analyse the draft rescue plan.

In reorganisation proceedings, the powers of the company’s directors may be suspended.

Ongoing Contracts

During the observation period, the administrator may demand that existing contracts with both vendors and customers continue to be honoured, notwithstanding any legal or contractual provision to the contrary.

The administrator may select which contracts are to be continued on the grounds that they have a positive effect on the bankruptcy cash flow or improve the chances of finding a successor or continuing the operation.
If the administrator decides to continue a contract, he must comply with the terms and conditions of the contract in effect at the date of the opening judgment.

The administrator may also decide to terminate unilaterally and without prior notice any contract with both vendors and customers if he considers that it is not necessary or has a negative effect on the situation of the company. In such cases, the contracting party may claim for damages resulting from the termination of the contract. However, such damages are considered as pre-bankruptcy claims which have to be filed with the creditors’ representative.

**Claims**

Creditors to whom the company became indebted prior to the commencement of the insolvency proceedings are required to file (declare) their claims in the insolvency proceedings within two months (four months for creditors domiciled outside France) of the publication in the BODACC (*Bulletin Officiel des Annonces Civiles et Commerciales*) of the judgment opening the proceedings. The declaration must specify the nature and amount of the claim. Failure to file the claim within this time limit bars the creditor barred from receiving distributions in the insolvency proceedings. However, the debtor must provide to the administrator and the creditors’ representative a list of the creditors to whom the company became indebted prior to the commencement of the insolvency proceedings. The debtor is presumed to have filed claims on behalf of the listed creditors until the creditors file their claims.

**Moratorium**

This procedure grants an automatic stay of all actions against the company and individuals acting as guarantors and joint debtors.

The proceeding entails:

- A prohibition, during the observation period, against paying any debt that arose before the opening judgment;
- Contractual and legal interest on debts ceasing to accrue (except in respect of loans for a term of one year or longer);
- A stay of proceedings for judgment on debt payments; these proceedings resume once the judicial administrator has been joined to the action, but the purpose of the proceedings is then only to fix the amount of the claim declared by the creditor;
- A stay on termination of contracts on the basis of payment default;
- A stay on enforcement measures by existing creditors;
- Prohibition of any new enforcement measures; and
- Possible debt waiver from tax and administrative bodies (but not for indirect taxes other than penalties and late interest).

The following exceptions to the automatic stay are provided:

- Set-off between connected claims: the French Supreme Court held that obligations are connected when they (i) result from a single contract, (ii) are carried out under a contract setting out the business relationship between the parties, or (iii) are carried
out under separate contracts which constitute a single global contractual arrangement;

- Claims secured by a security interest conferring a retention right: during the observation period, at the request of the administrator, the insolvency judge may exceptionally authorize the payment of a pre-filing creditor to obtain from that creditor the surrender of the retained asset to the estate. The asset must be necessary to the debtor's pursuit of its business activity. Note that creditors with a retention right resulting from possession of an asset belonging to the debtor company (and not from a security interest) have the same rights; and

- Claims assigned by way of Daily assignment of receivables: Daily assignment refers to the assignment for security by a credit institution of any claim that it may hold against a third party private-law or public-law legal entity or individual (if the claim relates to his business activities), simply upon submission of an advice note. The credit institution to which the debtor’s receivables have been assigned by way of Daily assignment can directly seek payment of the assigned receivables, notwithstanding any filing for safeguard or reorganisation proceedings.

**Safeguard/Reorganisation Plan**

The draft safeguard/reorganisation plan must be submitted to the creditors, who then vote on the plan.

Two creditors’ committees must be created if the accounts of the creditors have been either certified by statutory auditors or prepared by chartered accountants and the debtor has more than 150 employees or an annual turnover greater than EUR 20 million. Upon request of the debtor or the judicial administrator, the court can order the creation of creditors’ committees even though these criteria are not met.

There are two categories of creditors: credit institutions and major suppliers (i.e. suppliers holding more than 3% of the total of the suppliers’ claims), which are organized through committees.

The committees can discuss and vote on the safeguard plan proposed by the company. The safeguard/reorganisation plan can involve debt-restructuring, recapitalisation of the company, debt-for-equity swaps, sales of assets and partial sale of the business. A differential treatment of the creditors may be provided for if the differences in situation justify it; subordination agreements and agreements submitting a creditor’s vote to specific conditions are enforced. For a committee to approve the plan, the creditors representing at least two-thirds of the amount of claims held by the members of that committee must vote in favour.

Bondholders, although not members of the committees, must be consulted separately as a group once the committees of creditors have approved the plan.

If both committees and the general meeting of bondholders accept the draft plan and the court is satisfied that the plan protects the interests of the creditors as a whole, the court will approve the safeguard plan. From the date of the judgment approving the plan, the plan will be binding on all members of the committees and on the bondholders, including those who voted against the draft plan.

The court’s decision approving the plan must occur within six months of the opening judgment. Failing that, the creditors’ consultation will be undertaken according to the standard consultation process (i.e. the creditors will be consulted individually). If one or both
of the committees or the general meeting of the bondholders rejects the plan, or the committees or the bondholders do not vote within the period provided for by law, or the court does not approve the draft plan notwithstanding the approval of the committees, the committees will be dissolved and the safeguard/reorganisation proceedings will continue. The judicial administrator will seek individual agreements with each creditor to cancel or reschedule their debts as if they were creditors outside the committees.

Regarding the creditors who are not members of the committees or bondholders, the administrator makes individual arrangements with them to reschedule and/or waive part of their claims. With respect to dissenting creditors (i.e. creditors who are individually consulted and do not accept the proposition made by the administrator), the court can reschedule repayment of their debts over a maximum period of 10 years, except for debts with maturity dates of more than 10 years, in which case the maturity date will remain the same. In such a case, the first payment must be made within a year of the judgment adopting the plan. In the third and subsequent years, the amount of each annual instalment must constitute at least 5% of the total amount of the debt. The court cannot force a dissenting creditor that is not a member of a committee or a bondholder to waive part of its claim or to swap debt for equity.

If a safeguard plan is approved, the court appoints an insolvency practitioner (commissaire à l'exécution du plan) who ensures that the safeguard plan is implemented in accordance with its terms.

**Accelerated Financial Precautionary Procedure, or the French Pre-Packaged Restructuring**

**Objectives**

The objective of the law of 22 October 2010, which created the accelerated financial precautionary procedure, is to facilitate the recovery of companies whose operational activities are not in deficit, but which have a financial debt not conveniently adapted to their capacity of repayment.

The law’s purpose is also to enable companies whose activities are viable but which are strongly indebted to their financial creditors (financial institutions and bondholders) – and for which a conciliation procedure did not succeed in overcoming their difficulties because of recalcitrant minority creditors – to attain a safeguard plan that will bind only the debtor and its financial creditors.

The ordinance dated 12 March 2014 has extended this procedure to creditors other than financial creditors by creating the accelerated precautionary procedure.

**Duration**

The proceedings last a maximum of one month starting from the opening judgment of the safeguard proceedings for accelerated financial precautionary procedure (it is possible to renew this period once) and three months starting from the opening judgment of the safeguard proceedings for accelerated precautionary procedure.

**Conditions of the Company’s Eligibility for the Accelerated Financial Precautionary Procedure**

To request such proceedings, the company must fulfil the following conditions:

- Have more than 20 employees, or an annual turnover above EUR 3 million;
- Not be in cessation of payments;
• Face serious financial difficulties;
• Have started a conciliation procedure; and
• Have in place a sustained plan for future activities and financing, a list of debts elaborated by the auditor and a list of goods and services.

The Procedure

• Introduction of a demand, by the debtor, to the court;
• Report issued by the conciliator;
• Decision by the court as to whether to open the procedure;
• Setting up of the meeting of the financial creditors and, if applicable, of the bondholders’ meeting on the day of the opening judgment (L. 628-4);
• List of the debts drawn up by the debtor and transmitted to the court within 10 days from the opening judgment (L. 628-7 & R. 628-8);
• Proposals by the debtor submitted to the concerned creditors (L. 626-30-2), who vote on the proposals within 20 to 30 days following the transmission of the proposals; the court may reduce this timescale to 8 days for the meeting of the financial creditors and to 10 days for the bondholders’ meeting (L. 628-10);
• Plan adopted within one month (renewable once) from the opening judgment; if this deadline passes, the court will terminate the procedure.

Conditions of the Company’s Eligibility for the Accelerated Precautionary Procedure

To request such proceedings, the company must fulfil the following conditions:

• Have more than 20 employees, and an annual turnover greater than or equal to EUR 3 million or a balance sheet greater than or equal to EUR 1.5 million;
• Not having been in cessation of payments (for more than 45 days);
• Face serious financial difficulties;
• Have started a conciliation procedure; and
• Have in place a sustained plan for future activities and financing, a list of debts elaborated by an auditor and a list of goods and services.

The Procedure

• Introduction of a demand, by the debtor, to the court;
• Analysis by the court of the report issued by the conciliator;
• Decision by the court as to whether to open the procedure;
• If the court decides to open the procedure, setting up of the creditors’ committees (if the committees have not already been set up);
• List of the debts drawn up by the debtor and transmitted to the court within 10 days from the opening judgment;
• Proposals made by the debtor submitted to the concerned creditors (L. 626-30-2), who vote on the proposals within 20 to 30 days following the transmission of the proposals; the court may reduce this timescale to 15 days;
• Plan adopted within three months; if this deadline passes, the court will terminate the procedure.

**Liquidation**

If it is obvious that the company in cessation of payments has no chance for recovery, the court immediately orders its judicial liquidation.

Furthermore, at any time during the observation period, the court can order the liquidation of the company if it appears that the company has no more money to continue operating.

In case of liquidation, there is also an immediate stay of claims. Contracts entered into by the debtor are automatically terminated, except if the court orders a temporary continuation of the business.

The employees must be dismissed within 15 days of the judgment ordering the liquidation.

**Clawback Mechanisms**

The opening judgment determines the date on which the company effectively became unable to pay its debts as they came due.

This date, which may be a maximum of 18 months before the date of filing, is of particular importance because certain payments made, or commitments entered into, by the company during the period between that date and the date of the opening judgment (the clawback period *) are subject to cancellation by the court if they are not found to be in the interest of the company.

**Sanctions**

The sanctions hereafter described apply to official and *de facto* managers. Consequently, if the judicial liquidator considers that a person has intervened in the day-to-day management of the company, said person may be subject to the same criminal/civil sanctions as if he had been a duly appointed legal manager of the company.

This could be the case, for instance, for an officer or director of the parent entity/affiliate company. In such cases, the liquidator may consider that the parent entity/affiliate company was a *de facto* manager since it made decisions on behalf of the company.

**Financial Sanctions**

The sanction hereafter described only applies in case of judicial liquidation or cancellation of a continuation plan. It does not apply when a continuation plan is approved by the court and successfully completed. If the proceedings reveal that the insufficiency of assets results from a failure of management (*faute de gestion*), the court may decide that the debts of the company should be borne, in whole or in part, by its legal or *de facto* managers (*comblement de l’insuffisance d’actif*).

Under French statutory law, there is no definition of mismanagement. However, analysis of French case law shows that lack of investments, transfer of customers, continuation of a
business in deficit, lack of restructuring of the company, incomplete accounting, etc. may be considered mismanagement.

**Professional Sanctions**

As described herein, and under a series of other causes for action, the court may, notably, forbid the managers to manage or control any company for at least five years (faillite personnelle).

*Faillite personnelle* may arise where managers misappropriate or conceal assets or fraudulently increase liabilities, having omitted to make the declaration of cessation of payments within the time limit of 45 days.

**Criminal Sanctions**

Managers will be charged with bankruptcy (*banqueroute*) if they have, notably, misappropriated or concealed assets, fraudulently augmented liabilities or, with intent to avoid or postpone the commencement of the judicial reorganisation, made purchases in order to resell them below the market price or employed ruinous methods to obtain funds. The managers charged with *banqueroute* are subject to imprisonment of five years and a fine of EUR 75,000.

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Overview and Introduction

The main objective of any insolvency in Germany is to satisfy all creditors of the insolvent debtor jointly and equally to the greatest extent possible. This can be achieved either by way of liquidation or by corporate restructuring. In an insolvency of an individual the individual’s assets that are not protected from legal enforcement are used to satisfy the creditors and the individual may eventually be granted discharge from his residual debt.

Applicable Legislation

Insolvencies are mainly governed by the Insolvency Code (“Insolvenzordnung”; the “IC”), which applies regardless of which industry a debtor is in. In addition, special rules apply to certain financial sector institutions: some aspects of insolvency proceedings regarding credit institutions and insurance companies are governed by special provisions of the Act on Credit Institutions (“Kreditwesengesetz”) and of the Act on the Supervision of Insurance Companies (“Versicherungsaufsichtsgesetz”) respectively, modifying the rules of the IC, in particular by providing that only the German Federal Financial Supervisory Authority (“BaFin”) has the right to apply for the opening of insolvency proceedings for these banks and insurers (and similar institutions). Furthermore, following the recent financial crisis, the financial sector has been subject to new legislation aimed at avoiding insolvencies of system-relevant credit institutions.

The German government has started to implement a thorough reform of important aspects of German insolvency law. The reform is divided into three packages.

The first package, which has already been implemented, is aimed at improving the framework for corporate restructurings in general, and in particular for banks. In December 2010, the German parliament enacted a law on the Reorganization of distressed banks (“Restrukturierungsgesetz”). Amongst the core elements of the new law is the introduction of a pre-insolvency Reorganization regime for credit institutions intending to support voluntary Reorganization efforts. In addition, the BaFin may take over control of credit institutions (via a special commissioner) and impose, inter alia, Reorganization schemes. When the existence of a system-relevant credit institution is threatened, the BaFin is further entitled to order a carve-out of system-relevant parts of the credit institution and a subsequent transfer of these parts to a new entity. The idea behind this new “good bank” model is to focus the restructuring efforts on the system-relevant parts of the credit institution. Another important aspect of the new law is the introduction of a Reorganization fund to be financed through mandatory contributions by credit institutions and used for recapitalisation measures of system-relevant banks.

As a further part of the first reform package, the “Law to Further Facilitate the Restructuring of Companies” (“Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen”; the “ESUG”) came into force on March 1, 2012. The ESUG has substantially amended the Insolvency Code by increasing predictability of insolvency proceedings and offering new restructuring tools:

- Creditors have greater influence on the selection of the insolvency administrator.
- Timely filings for insolvency by debtors are rewarded by:
  - the insolvency court ordering that the proceedings will be run as debtor-in-possession proceedings (Eigenverwaltung);
a debtor’s right to select a custodian merely supervising its actions instead of an insolvency administrator being appointed to take control;

- the provision of a “protective shield” (similar to a moratorium) under which the debtor may work out its insolvency plan.

- Insolvency plan proceedings are improved by:
  - limiting legal remedies so that individual creditors can no longer block the insolvency plan;
  - providing for the possibility of including the insolvent company’s shareholders in the plan so that a company may be restructured over their objection, without dissolution;
  - making debt-equity swaps possible, even if the insolvent company’s shareholders do not consent;
  - mitigating statutory capitalisation rules in the event of a debt-equity swap.

The second reform package deals in particular with the insolvency of individuals, a key element of which is to improve individuals’ access to discharge from their residual debt on their request. It came into force on July 1, 2014.

The third package will address specific challenges related to group insolvencies. In January 2014, the German government issued a bill whose core elements are described below (Debtors: Insolvency of Legal Entities).

Debtors

The subject of insolvency proceedings (i.e., the debtor) can be either an individual or any type of private law entity, be it a corporation or a partnership. Generally, also legal entities organized under public law are subject to insolvency proceedings. However, insolvency proceedings may not be opened with respect to the assets of (i) the Federation (“Bund”), (ii) any federal state (“Land”), or (iii) any legal entity organized under public law which is under the supervision of a federal state if the law of that federal state exempts the entity from insolvency proceedings.

Personal Insolvencies

Individual insolvencies are in principle governed by the same set of rules as insolvencies of legal entities, but with some substantial modifications.

To individuals who are pursuing an independent business activity, in principle the same rules apply as to legal entities. The main difference is that an individual may apply for a discharge of residual debt after completion of insolvency proceedings, provided that the individual himself has applied for the opening of the proceedings. Furthermore, the debtor needs to be eligible for discharge of residual debt or his application may be rejected by court order upon petition of any creditor. For instance, a debtor who has been finally convicted of a bankruptcy crime pursuant to sections 283–283c of the Criminal Code (“Strafgesetzbuch”), or who has substantially breached his information or cooperation duties during the insolvency proceedings, is not eligible for discharge of residual debt.

If the insolvency court orders a discharge of residual debt, then the debtor enters a compliance period during which he is under a duty to pursue a gainful activity or, if unemployed, seek acceptable employment. Any income of the debtor during the compliance
period exceeding a minimum amount (which may not be seized) is used to satisfy the creditors. The debtor risks that discharge from residual debt will not be granted if he conceals any income from his creditors. Principally, the compliance period lasts for six years from the opening of insolvency proceedings. Within the second reform package, the compliance period of individuals to achieve a discharge is shortened from six to three years if the debtor pays 35% of his debts and covers the costs of insolvency proceedings or is shortened to five years by settling the costs of the insolvency proceedings. Provided that the debtor complies with his duties during the compliance period, the court will order discharge from residual debt, with the exception of certain liabilities, such as, e.g., fines, certain tax liabilities, unlawfully withheld alimony or debt created by intentional tort.

Individuals who have not pursued an independent business activity must try an out-of-court debt adjustment before their own insolvency petition will be considered by the insolvency court. If on the other hand a creditor files for insolvency an attempt to an out-of-court debt adjustment is not necessary. If insolvency proceedings are eventually opened, the proceedings are somewhat simplified compared to regular insolvency proceedings. The same applies to individuals who have previously pursued an independent business activity, provided their financial situation appears easily manageable.

Insolvency of Legal Entities

Legal entities organized under private law are in general subject to insolvency proceedings, regardless of their corporate form and regardless of whether these entities are privately owned or state-owned. Legal entities under public law may be exempted from insolvency proceedings if applicable public law so provides. This exemption applies in particular to municipalities.

German law does not recognize the concept of group insolvencies. Therefore, if several entities of a group of companies file for insolvency, separate insolvency proceedings will be initiated for each entity. While this principle may not change when the third reform package will be implemented, the current bill issued by the German government contemplates instruments to better coordinate group insolvencies, in particular by concentrating the proceedings of the various group entities at one single court (Gruppengerichtsstand) and under the administration of one group administrator (einheitlicher Insolvenzverwalter). In addition, the bill provides for cooperation duties between insolvency administrators, insolvency courts and creditors’ committees (Kooperationspflichten) and additional proceedings coordinating the individual insolvency proceedings by a coordination administrator (Koordinationsverfahren) to improve the handling of several company insolvencies in a group.

Typical insolvency proceedings in Germany involving a commercial business entity are divided in two phases: the interim or preliminary proceedings and the main proceedings. After the management of the insolvent entity or a creditor has applied to the competent insolvency court for the opening of insolvency proceedings, the insolvency court appoints either (i) a preliminary custodian ("Sachwalter") supervising the ongoing management of the debtor-in-possession, or (ii) a preliminary insolvency administrator who secures the assets of the debtor. Under the new German insolvency law – as reformed by the ESUG – as a general rule, a (preliminary) custodian must be appointed, if so requested by the debtor's management. Normally, the preliminary custodian, or, as the case may be, the preliminary insolvency administrator, determines whether the main proceedings should be opened, in particular, whether there are sufficient assets to at least cover the cost of the proceedings. Depending on the custodian's/preliminary insolvency administrator's findings, the insolvency court may then open the main proceedings.
When insolvency proceedings are opened, the preliminary insolvency administrator is usually appointed to act as insolvency administrator; similarly, the preliminary custodian should usually become the custodian if the proceedings continue as debtor-in-possession proceedings.

The insolvency administrator will try to continue the business of the debtor or parts of it in the best way possible, e.g., by selling the business or parts of it to an investor. Any remaining business of the company is liquidated and the assets sold. Preferred creditors, e.g., creditors who hold title to assets in the possession of the debtor, who hold security rights, or whose claims came into existence after the opening of the main insolvency proceedings, may be able to reclaim their assets or satisfy their rights and claims in full. All other creditors, in particular creditors with payment claims that came into existence before the opening of the insolvency proceedings, are usually able to obtain only a small percentage of their claims: the “insolvency quota”. The insolvency quota typically ranges between 0% and 10%, but can also be significantly higher. Full recovery of the debt is rare, but happens occasionally. It is often tried to restructure the debtor by an insolvency plan instead of selling/liquidating its business, particularly if a custodian is appointed.

The remainder of this Chapter focuses on insolvencies of entities under private law organized as corporations. Any peculiarities applying to other private law entities and public law entities are not discussed.

Creditors

While German insolvency law focuses on equal satisfaction of the creditors, it does recognise different classes of creditors:

- Creditors with rights of separation (described below) have a right to separate their assets from the debtor's estate. They do not belong to the insolvency creditors in the narrow sense of the word;
- Secured creditors have a right of separate satisfaction. Compared to creditors with rights of separation they face certain limitations of their legal entitlements;
- Estate creditors (i.e., with some exceptions, creditors whose claims arise upon or after the opening of formal insolvency proceedings) are satisfied before ordinary insolvency creditors;
- Insolvency creditors usually receive only a small fraction of their claims’ nominal value. Their claims may also rank differently; for example, claims for repayment of shareholder debt are subordinated by operation of law.
- Any remaining proceeds from the insolvency proceedings after satisfaction of all other creditors are distributed among the debtor’s equity holders. Such distribution is the rare exception.

Preferred Creditors

Preferred creditors are creditors who hold either a right of separation (typically if a creditor holds title to assets in the possession of the debtor – see “Right of Separation” below), or a right of separate satisfaction (if a creditor holds a security interest in an asset of the debtor – see “Right of Separate Satisfaction” below), or creditors who can claim preferred satisfaction as creditors of the insolvency estate (typically, if a claim has been established by the insolvency administrator – see “Estate Creditors” below).
A creditor claiming a right of separation or separate satisfaction needs to be able to demonstrate its valid security for any individual assets. For instance, if a creditor claims a right of separation for ten trucks and the debtor has 20 identical trucks stored in its warehouse, the creditor needs to be able to demonstrate and prove to which of these trucks it holds title. To be able to submit the required proof of title, any creditor should therefore keep track of its property and, e.g., request that its property be kept separate on the debtor’s premises, mark its property as appropriate, and/or keep track of the serial numbers of any goods delivered to the debtor.

Right of Separation

A creditor has a right of separation in particular if it has legal title to any assets in the debtor’s possession. This right benefits, for instance, suppliers who have retained title to the supplied products and leasing companies. Creditors with rights of separation can eventually request return of their goods and will generally suffer least from the debtor’s insolvency.

Contractual rights generally (exceptions being, e.g., certain arrangements comparable to trusts) do not entitle a creditor to separation. If, for example, someone has purchased goods from the debtor and if title has not yet passed to the purchaser, the purchaser may not demand separation even if he has made partial or even full payment.

Right of Separate Satisfaction

A right of separate satisfaction exists if the creditor has a security interest in an asset of the debtor, e.g., a pledge, a security assignment of a movable item or of a claim, or, in certain cases, a withholding right. The creditor may claim priority satisfaction out of the proceeds from the sale of the specific asset.

Rights of separate satisfaction are often held by suppliers who delivered their products under all-monies clauses ("erweiterter Eigentumsvorbehalt"), which provide that the title of the delivered good be transferred under the condition that all deliveries or all receivables from the contractual relationship are fully settled, or under extended retention of title clauses ("verlängerter Eigentumsvorbehalt"), which provide that all receivables resulting from the resale of delivered goods are assigned in advance and that the supplier acquires joint ownership in new goods in the event that the delivered goods are processed, joined or mixed.

In insolvency cases involving suppliers, the suppliers often join a suppliers’ pool ("Lieferantenpool") in order to coordinate their rights and assert their security interests.

To the extent that claims of secured creditors with rights of separate satisfaction are not satisfied by the realisation of their respective security interests, they can claim on their remaining claims the same quota as unsecured insolvency creditors.

Estate Creditors

If a creditor acquires claims against the debtor when the debtor has already entered insolvency proceedings, the claims may be privileged. Such claims are known as “estate claims”. A creditor who has an estate claim is called an “estate creditor”. Estate claims are, in particular, any claims created by the insolvency administrator after the opening of insolvency proceedings. Likewise, consideration for performance rendered after the opening of insolvency under pre-existing contracts for which the insolvency administrator has opted for performance can be claimed as estate claims (see below). Claims created by a preliminary insolvency administrator can be claimed as estate claims only if the preliminary administrator was appointed as a “strong” preliminary administrator or if the insolvency court
had specifically vested in the preliminary insolvency administrator the power to create certain estate claims, which is only rarely the case.

Estate claims are usually paid in full when due, unless the assets of the insolvent debtor prove insufficient to cover all estate claims. If the estate claims are not fully covered, the estate creditors may under certain circumstances hold the insolvency administrator liable for the losses they incur due to insufficient assets.

**Insolvency Creditors**

Insolvency creditors are creditors with unsecured claims that came into existence prior to the opening of insolvency proceedings. However, this class does not include exceptional creditors that can claim preferred treatment as insolvency estate creditors (see above). Insolvency creditors are rarely paid in full but receive only a quota on their claims. This insolvency quota amounts to approximately 5% on average. It is often lower, particularly in small insolvencies, but can also be significantly higher.

Within the group of unsecured insolvency creditors, claims have different ranks. Lower ranked claims are only paid after all higher ranked claims have been fully satisfied. For instance, monies due under a shareholder loan (with some exceptions) have a lower rank compared to third-party claims of the debtor’s business partners. Further, interest on the filed claims of the insolvency creditors accruing after the opening of insolvency proceedings ranks behind principal amounts. Unlike in several other jurisdictions, insolvency claims of employees or tax or other public authorities generally do not rank above insolvency claims of other creditors, e.g., suppliers or customers. However, certain tax claims stemming from the preliminary insolvency proceedings (i.e., the period after the filing of the insolvency petition and prior to the opening of formal proceedings) have the quality of estate claims.

Insolvency creditors must file their claims with the insolvency administrator. While insolvency creditors are called to do so within the deadline ordered by the insolvency court in its opening order, they can file their claims after this deadline has expired until right before the final distribution of proceeds takes place. Any filing of insolvency claims needs to properly identify the relevant claims, indicate the basis of the claims, and be backed by appropriate documentation (such as contracts and invoices, etc.). Insolvency administrators usually provide creditors with standard forms which can be used for the filing. However, depending on the complexity of the matter, creditors often seek professional advice to handle such filings.

**Creditors’ Bodies**

Creditors have the opportunity to influence the insolvency proceedings through three creditors’ bodies: the creditors’ assembly, the preliminary creditors’ committee and the creditors’ committee.

**Creditors’ Assembly**

The creditors’ assembly consists of all insolvency creditors and creditors with rights of separate satisfaction. Creditors with rights of separation do not belong to the creditors’ assembly. The debtor and, respectively, its representatives and the insolvency administrator are entitled to attend meetings of the creditors’ assembly. These meetings are chaired by the insolvency court. At certain important stages of the insolvency proceedings such meetings must be summoned. Further, they have to be summoned on the request of the insolvency administrator, the creditors’ committee or a specified number of creditors holding a certain percentage of all insolvency claims. In creditors’ assembly meetings, the creditors vote by the amount of their respective claims and in some cases also per capita. Among others, the following creditors’ assembly meetings are mandatory:
• A meeting no later than three months after the opening of the insolvency proceedings to decide on the basis of a report of the insolvency administrator as to how the insolvency proceedings will be conducted (“report hearing”);

• A meeting no later than two months after the deadline to submit insolvency claims has ended to decide on the validity of the claims submitted (“examination hearing”). Both the examination hearing and the report hearing are scheduled by the insolvency court when the insolvency proceedings are opened and may coincide;

• A meeting at the end of the insolvency proceedings when the insolvency administrator presents to the creditors a final financial report on the result of the insolvency proceedings.

The creditors’ assembly has the authority to make important decisions in the insolvency proceedings, e.g., to:

• Establish or abolish a creditors’ committee or replace its members (see below);

• Replace the insolvency administrator;

• Decide on the temporary continuation of the debtor’s business;

• Decide on whether an insolvency plan is to be prepared (see below).

Although the creditors’ assembly has numerous means to influence the insolvency proceedings, typically attendance at creditors’ assembly meetings is rather low. Further, the creditors’ assembly usually follows the recommendations and suggestions of the insolvency administrator. Creditors should always consider attending creditors’ assembly meetings because these meetings offer the opportunity to gain additional information on the insolvency proceedings and the prospects of recovery of outstanding claims. The creditors may also send a representative with a proper power of attorney.

Preliminary Creditors’ Committee

The preliminary creditors’ committee generally has to be appointed by the insolvency court during the preliminary insolvency proceedings if a mid-sized or large company is involved. But also in respect of small companies, the in-solvency court is supposed to appoint a preliminary creditors’ committee if the debtor, the preliminary insolvency administrator or a creditor request its appointment and if persons are nominated as members who may participate in the committee and are willing to do so. Ideally, the members of the committee shall include creditors with a right of separate satisfaction, insolvency creditors with the highest claims, small creditors and a representative of the employees. Often, also a representative of the pension security fund is a member of the committee. There is no fixed number of members of the preliminary creditors’ committee and, in contrast to the creditors’ assembly, the creditors vote only per capita.

One important right of the preliminary creditors’ committee is to participate in the appointment of the (preliminary) insolvency administrator/custodian: The preliminary creditors’ committee is to be heard by the insolvency court before the appointment. In case the committee unanimously agrees upon a certain (preliminary) insolvency administrator/custodian, the insolvency court may deviate from this nomination only if the person proposed is not suitable to hold the office. The preliminary creditors’ committee may also agree on a profile that the administrator/custodian must meet and which the insolvency court has to take into account when appointing.
Besides its participation in the appointment of the administrator/custodian, the preliminary creditors’ committee is also involved in the decision whether the (preliminary) proceedings are run as debtor-in-possession proceedings (Eigenverwaltung) (see “Debtor-in-Possession Proceedings” below). The preliminary creditors’ committee is to be heard unless such hearing would obviously lead to a deterioration of the debtor’s financial position. If the preliminary creditors’ committee unanimously supports the debtor’s application for debtor-in-possession proceedings, it shall be granted.

Creditors’ Committee

A creditors’ committee need not necessarily be appointed – not even in mid-size or large insolvencies. Prior to the first creditors’ assembly the insolvency court may establish a creditors’ committee; afterwards the creditors’ assembly itself is charged with the establishment. As with the preliminary committee, there is no fixed number of members and voting is per capita.

The creditors’ committee supports and supervises the insolvency administrator (or, in the event of debtor-in-possession proceedings, the debtor) in his management activities, but does not have the right to instruct the insolvency administrator (the debtor). Because it is a smaller body, the committee can be summoned more often and more easily than the creditors’ assembly. Thus, if a creditors’ committee is constituted, it replaces the creditors’ assembly for certain decisions, e.g., certain actions of the insolvency administrator (the debtor) are subject to the committee’s approval and not the assembly’s approval. Examples of such actions are the sale of the business or significant assets of the debtor. However, once the creditors’ assembly meets for the first time, it may abolish the creditors’ committee or replace its members.

Insolvency Administrator

The insolvency administrator manages the affairs of the insolvent company and ensures that the creditors are satisfied to the maximum extent possible. After the submission of an application to open formal insolvency proceedings, a preliminary insolvency administrator is appointed by the insolvency court (for the participation of the preliminary creditors’ committee, if applicable, see above), unless the proceedings are run as debtor-in-possession proceedings, in which case instead of an administrator a custodian is appointed (see below). Each local court holds a list of insolvency practitioners − in most cases qualified lawyers − and usually appoints a person from this list as preliminary insolvency administrator, though this is not mandatory and may be overruled by a unanimous decision of the preliminary creditors’ committee (see above). If formal insolvency proceedings are opened, the court appoints an insolvency administrator. In most cases the preliminary insolvency administrator is also appointed as insolvency administrator.

Preliminary Insolvency Administrator

The court may vest the preliminary insolvency administrator with different degrees of authority. The “strong” administrator takes over the debtor’s right to manage and transfer the debtor’s property. In cases where a “weak” administrator is appointed, the debtor formally remains entitled to manage its property, but usually the insolvency court will order that any act of disposal (e.g., any payments, transfer of rights or assets, etc.) by the debtor requires the consent of the administrator. This means that even a weak preliminary insolvency administrator will practically take over management functions and may be the main contact for the creditors during preliminary insolvency proceedings.

Obligations created by a strong administrator are privileged and are paid from the insolvency estate before other creditors are satisfied (see above). On the other hand, obligations created by the debtor with the consent of a weak preliminary administrator are not privileged,
unless upon specific order of the insolvency court. Any creditor would be well advised to exercise due care when continuing business with a debtor in the state of preliminary insolvency proceedings, because it may end up only with additional insolvency claims, typically with a very low recovery rate.

The task of the preliminary insolvency administrator is to evaluate the current financial situation of the debtor, to monitor the actions of the debtor and protect the debtor’s assets for the benefit of the community of creditors, and to develop a strategy of how to conduct the insolvency proceedings. The preliminary insolvency administrator is entitled to access all the debtor’s books and records and to conduct inquiries among the debtor’s management as well as among third parties. The debtor’s management must actively support the preliminary insolvency administrator’s efforts. The insolvency court may at its discretion vest additional powers in the preliminary insolvency administrator. The preliminary insolvency administrator will summarise his conclusions in a report to be submitted to the insolvency court.

Insolvency Administrator

The insolvency administrator must decide how best to use the assets of the debtor to ensure that the creditors are satisfied and must take all necessary measures to this effect. Typically, he follows the strategy already decided upon during the preliminary insolvency proceedings. His main options are to either liquidate the business altogether or try to sell all or parts of it (for further options, see below).

As opposed to a weak preliminary insolvency administrator, the insolvency administrator is authorised to represent the debtor and enter into agreements on its behalf. Any claims from such agreements are treated as preferred claims which have to be fulfilled completely by the insolvency administrator from the insolvent estate when due. If the assets of the debtor are not sufficient to satisfy these claims, the insolvency administrator may be liable to the creditor. Thus, generally speaking, a creditor has the prospect that claims created after the opening of the insolvency proceedings, as opposed to claims created before the opening of the insolvency proceedings, will be fully satisfied.

Reasons for Insolvency

Insolvency proceedings can only be initiated if a formal reason for insolvency exists.

If filed by the debtor or by a creditor, the insolvency petition can be based on illiquidity (“Zahlungsunfähigkeit”);

And, if the debtor is a legal entity, also on over-indebtedness (“Überschuldung”);

In addition, petitions filed by a debtor itself may also be based on the reason of imminent illiquidity (“drohende Zahlungsunfähigkeit”).

Illiquidity

A debtor is considered illiquid, if it is – other than only temporarily – unable to meet its due payment liabilities (section 17, para 2, sentence 1 of the IC). Under current German case law, an inability is considered only “temporary” if it can be overcome (e.g., by borrowings from banks) within three weeks. Furthermore, if the debtor can meet at least 90% of its due payment obligations, it will also generally not be considered illiquid. In other words, if a liquidity gap can be rectified within three weeks or amounts to less than 10% of all due payment liabilities, the debtor can generally still be regarded as solvent unless it is foreseeable that the liquidity gap will exceed the 10% threshold in the future. If the debtor has ceased making any payments, it is generally considered illiquid.
Over-Indebtedness
A debtor is considered over-indebted (section 19, para 2 of the IC) if:

- It has a net deficit, i.e., the total amount of its liabilities (including reserves for contingent liabilities) exceeds the total amount of its assets (including undisclosed reserves); and, in addition,
- The likelihood of a debtor’s avoiding an illiquidity over a medium term (i.e., in general – though different terms may apply depending on the debtor’s business – at least until the end of its following fiscal year) is 50% or less, i.e., the prospects of the debtor surviving as a going concern are insufficient (the “going concern test”; “Fortführungsprognose”).

The prospects must be determined on the basis of a well-prepared profit-and-loss financial plan (“Ertrags- und Finanzplan”). It is prudent to have this plan prepared by an independent auditor. Whether the debtor has a net deficit is not determined on the basis of its financial statements under applicable GAAP, but using a special balance sheet for insolvency test purposes (“insolvency test balance sheet”; “Überschuldungsstatus”), in which any marketable assets (including the debtor’s self-created intellectual property and, if marketable, its goodwill) may be shown at their fair market value.

Imminent Illiquidity
Imminent illiquidity allows the debtor – but not its creditors – to initiate insolvency proceedings if the debtor is likely to become unable to meet its future payment obligations when they fall due. The test to apply for determining whether illiquidity is imminent is similar to the going concern test to be applied when assessing whether the debtor is over-indebted.

Filing Rights and Obligations
In the event of illiquidity and/or over-indebtedness, the managers of any legal entity providing for limited liability (e.g., the directors of a stock corporation (Aktiengesellschaft) or the managing directors of a limited liability company (Gesellschaft mit beschränkter Haftung)) need to file for insolvency without undue delay, but not later than three weeks after the illiquidity and/or over-indebtedness occurs. If they do not file in time the managers are subject to personal liability – both under civil and under criminal law. Imminent illiquidity does not obligate the management to make a filing but gives rise to only a right to file.

A creditor may file an insolvency petition against the debtor if the debtor is illiquid and/or over-indebted. A creditor filing must substantiate such illiquidity and/or over-indebtedness. If the debtor objects to the filing, the burden of proof is with the filing creditor.

Insolvency Proceedings
After filing of an insolvency petition with the competent insolvency court, the court opens formal insolvency proceedings if the debtor is (imminently) illiquid or over-indebted, as the case may be, and if the debtor has sufficient assets to cover the costs of the proceedings. The court also appoints an insolvency administrator; however, if the debtor applies for, and the court grants, a procedure under which the debtor’s management (and not the in-solvency administrator) remains in charge of the business decisions (see “Debtor-in-Possession Proceedings” below), then the court appoints instead a custodian to review the actions of the debtors. During formal insolvency proceedings the creditors’ assembly can decide to authorise the insolvency administrator to deviate from certain mandatory provisions applying to ordinary insolvency proceedings on the basis of an insolvency plan and, thereby, make the proceedings more flexible and tailor them to the needs of the particular debtor.
Opening Proceedings

The interim period between the filing of an insolvency petition until the opening of formal insolvency proceedings, called “opening proceedings”, “preliminary proceedings” or “interim proceedings”, is often crucial for the debtor as it is during the opening proceedings that the course for the insolvency proceedings is set.

The preliminary insolvency proceedings start immediately upon receipt of the insolvency petition and end with the court order adjudicating on the opening of formal insolvency proceedings; during this period the employees may receive payment of their wages from social security (“insolvency money”; “Insolvenzgeld”). A preliminary insolvency administrator will often use the insolvency money to keep the business operational and improve the debtor’s short-term liquidity situation.

Shortly following receipt of the insolvency petition, the insolvency court usually issues a court order determining the rules to be followed during the preliminary insolvency proceedings, including safeguarding measures to protect the debtor’s assets (e.g., restrictions on transfer of property by the debtor and suspension of measures of enforcement (unless relating to immovable assets)). German insolvency law, however, does not grant an automatic stay to prevent creditors from exercising rights against the debtor’s assets. The court order is published on the Internet (www.insolvenzbekanntmachungen.de), except when the court allows debtor-in-possession proceedings.

As mentioned above, unless the proceedings are run as debtor-in-possession proceedings, in all major insolvencies the insolvency court appoints in its court order a preliminary insolvency administrator who will control the debtor’s business. Creditors should no longer rely on the debtor’s staff and management, but should always involve the preliminary insolvency administrator or his team when taking decisions regarding their business relationship with the debtor.

Often, the preliminary insolvency administrator will take important actions which more or less predetermine the course of later formal insolvency proceedings. For instance, if the preliminary insolvency administrator finds that the debtor’s business is not profitable on a standalone basis, he will look for potential investors. The preliminary insolvency administrator may also develop a contract selling the debtor’s business (or parts of it) to an investor, subject to confirmation by the creditors and the (final) insolvency administrator after opening of formal insolvency proceedings. Especially in larger insolvency cases, when the preliminary insolvency administrator needs the creditors’ support to implement important actions (and to limit his liability risks when doing so), he may need a preliminary creditor’s committee to support his Reorganization efforts (see above).

Based on the preliminary insolvency administrator’s report, the insolvency court will decide whether there exists a valid reason for the commencement of insolvency proceedings and whether the debtor’s assets are likely to cover the costs of the proceedings, i.e., the administrator’s fees and court costs. If both of these criteria are met, the court will open formal insolvency proceedings.

Formal Insolvency

The court order opening the insolvency proceedings will usually be published immediately on the Internet (www.insolvenzbekanntmachungen.de) and served on the insolvent debtor, its creditors and debtors. Generally, unless the proceedings are run as debtor-in-possession proceedings (see “Debtor-in-Possession Proceedings” below), the court order will:

- Appoint an insolvency administrator (in most cases, the insolvency administrator is the same person as the preliminary insolvency administrator);
• Order the debtors of the insolvent debtor to make payments to the insolvency administrator’s trust account only and prohibit the debtors of the insolvent debtor from paying the debtor directly;

• Request the creditors of the insolvent debtor to file their claims against the insolvent debtor with the insolvency administrator and to inform the administrator about any security rights in the insolvent debtor’s assets;

• Set a deadline for the registration of the creditors’ claims;

• Docket meetings for the creditors’ assembly to decide on the further course of the proceedings (report hearing) and verify the filed claims (verification hearing).

The main consequences of the court order are:

• The debtor loses its right to manage and transfer its assets; this right is vested with the insolvency administrator;

• Any individual enforcement measures (unless relating to immovable assets) are prohibited;

• Any transfers of property by the debtor are invalid;

• Pending civil actions are interrupted;

• Pending agreements are subject to special provisions (e.g., under section 103 of the IC, the administrator’s option to choose performance or non-performance of mutual contracts which are not yet fully performed by both parties – see below).

During the report hearing, the creditors’ assembly will decide on the basis of a report of the insolvency administrator whether the debtor is to be immediately liquidated or continued for Reorganization. In most cases, the debtor is liquidated and its business or profitable parts of it may be sold to an investor. As already mentioned, such sale to an investor is often already pre-arranged during preliminary insolvency proceedings and the creditors’ assembly’s vote is simply required to close the transaction.

The insolvency administrator and the debtor have the option to set up an insolvency plan. The insolvency plan regime was introduced in Germany in 1999 and is inspired by US Chapter 11 proceedings. The insolvency plan, which is prepared either by the debtor or the insolvency administrator, may deviate from the rules set forth in the IC. Thus, it can be tailored to the needs of each case. For instance, the insolvency plan can propose that certain groups of creditors receive better treatment than others. An insolvency plan can also provide for a sale to an external investor. Insolvency plans used to be applied in rare cases only, but have substantially increased in popularity. For details, see “Restructuring by Insolvency Plan” below.

Debtor-in-Possession Proceedings

Instead of appointing an insolvency administrator who takes over the management of the debtor, upon the request of the debtor, the insolvency court may leave the debtor, i.e., its management, in control of the business throughout the insolvency proceedings (debtor-in-possession proceedings, “Eigenverwaltung”). This option is inspired by the similar concept under Chapter 11 of the US Bankruptcy Code. When the court orders debtor-in-possession proceedings, the company is both advised and supervised by a (preliminary) custodian (Sachwalter), who is empowered with certain rights and duties generally attributed to an
insolvency administrator, such as challenging avoidable transactions, but who has no direct control over the debtor’s operations.

Prior to the ESUG, debtor-in-possession proceedings had been granted under exceptional circumstances (to be shown by the debtor) only. The vast majority of the proceedings were run as “normal” insolvency proceedings with a (preliminary) insolvency administrator selected and appointed by the court. When filing for insolvency, debtors could expect to lose control over their businesses without even knowing who the (preliminary) administrator in charge would be; as a consequence, management tried to avoid a filing if at all possible and many filings were late.

The ESUG tries to establish debtor-in-possession proceedings as a general rule: The insolvency court shall now order debtor-in-possession proceedings if so applied by the debtor, provided that the court is not aware of any circumstances based on which it may be expected that such an order will disadvantage the creditors. If the preliminary creditors’ committee unanimously supports the debtor’s application, the law presumes that ordering debtor-in-possession proceedings will not disadvantage the creditors. If the debtor files for insolvency due to imminent illiquidity and applies for debtor-in-possession proceedings, but in the court’s view the prerequisites for such proceedings are not given, the court shall notify the debtor so that the debtor may withdraw the filing prior to the court’s decision. Once debtor-in-possession proceedings have been granted, the court may repeal its decision only if requested by (i) the creditors’ assembly by a majority in number and amount, (ii) a creditor with a right of separate satisfaction or an insolvency creditor, provided that the creditor credibly shows circumstances based on which it may be expected that the debtor-in-possession proceedings will disadvantage the creditors at large and substantially disadvantage the requesting creditor, or (iii) the debtor.

Following the introduction of the ESUG the insolvency courts have allowed debtor-in-possession proceedings significantly more often. In particular, large restructurings are increasingly conducted as debtor-in-possession proceedings by using the newly introduced “protective shield”.

Protective Shield

Since the ESUG has come into effect, debtors who intend to restructure their business without being dissolved may substantially benefit from earlier filing. If a filing is made in the event of imminent illiquidity and/or over-indebtedness but before the debtor is illiquid, the debtor may, as a debtor-in-possession, slip under a “protective shield” (Schutzschirm) which will unfold for a period of up to three months and enable the debtor to work out its insolvency plan (see “Restructuring by Insolvency Plan” below):

- The insolvency court may take a set of protective measures to secure the debtor’s assets. In particular, the court may – and, if applied for by the debtor, must – order a restriction on enforcement measures against the debtor.

- The debtor will stay in possession (see “Debtor-in-Possession Proceedings” above), unless it is obvious that the intended restructuring will fail. Moreover, the insolvency court will have to appoint the (preliminary) custodian proposed by the debtor, unless such custodian is obviously ineligible (e.g., because of a prior involvement).

- The debtor may apply for a preliminary creditors’ committee to be constituted and make proposals as to the members of such committee. Smart debtors will do so and make sure that creditors who support the restructuring dominate the committee: To terminate the “protective shield” a resolution of the creditor’s committee passed by a
A majority in number is required, unless the intended restructuring has failed – in which case the shield is removed anyway.

- Upon its request, the debtor will be able to create liabilities binding on the insolvency estate, i.e., estate claims (Masseverbindlichkeiten) ranking prior to any unsecured (pre-insolvency) claims of creditors (see “Creditors” above).

In other words: A timely filing of a debtor having ensured that the majority of its creditors support the intended restructuring will be honoured; it will allow the debtor to keep control and, at the same time, finalize its insolvency plan.

A major challenge and potential stumbling block when applying for a protective shield is the restructuring opinion that is required to support the application. The restructuring opinion needs to be issued by an independent and qualified restructuring professional based on an analysis of the business to be restructured. Preparing the opinion usually takes at least a few weeks and courts tend to set a high standard as to its content. Therefore, work on the restructuring opinion should be started as early as possible in the restructuring process.

**Selected Instruments of the Insolvency Administrator**

When taking over the management of the debtor, the insolvency administrator (or, in case the proceedings are run as debtor-in-possession proceedings, the custodian or the debtor’s management under supervision of the custodian) has various tools to ensure that the insolvency creditors are satisfied to the maximum extent possible. One important tool is to choose whether to perform certain mutual contracts. This option enables the insolvency administrator to prevent the consummation of certain transactions that may be to the disadvantage of the debtor. Another important tool of the insolvency administrator is the right to contest past transactions between the debtor and third parties or its shareholders or other group companies which may have put the other insolvency creditors at a disadvantage. If the insolvency administrator is successful, the other party to the transaction has to return to the debtor anything it obtained under the contested transaction. This increases the value of the assets which the insolvency administrator may distribute to the creditors.

**Mutual Contracts**

The insolvency administrator is entitled to opt for performance or non-performance of such mutual contracts (e.g., sales contracts or supply agreements) to which the debtor is a party and which upon opening of insolvency proceedings have not yet been fully performed by at least one party (sections 103 and 105 of the IC). If the insolvency administrator opts for non-performance, the contract remains suspended for the duration of the insolvency proceedings. The insolvency administrator can therefore refuse to perform under the contract and the creditor can terminate the contract and claim damages, but, typically, only as an insolvency creditor (see above). If the insolvency administrator opts for performance, he can claim outstanding performance under the contract. In return he has to pay the outstanding consideration as an estate claim (see above), but only to the extent that it relates to the creditor's performance after the opening of insolvency proceedings. For example, if the creditor has supplied 50 of 100 cars owed under a sales contract before the opening of insolvency proceedings and has received 30% of the purchase price, the insolvency administrator when opting for performance can request delivery of 50 cars and in return has to pay not the outstanding 70% of the purchase price, but only 50%. The difference of 20% can be claimed by the supplying creditor as an insolvency claim, only.

The insolvency administrator’s right does not apply to every mutual contract. Certain types of contracts are governed by special provisions. This is the case, for instance, for certain purchase agreements where the seller has retained title to a good sold, for certain rental
agreements (which continue to be effective, but with termination rights modified for the benefit of the debtor), certain leasing agreements, loans granted by the debtor, service agreements and agency agreements.

Avoidance Rights

The insolvency administrator is entitled to void certain contracts and transfers of assets made by the debtor prior to the opening of insolvency proceedings. Generally, transactions are voidable only if they set the other insolvency creditors at a disadvantage. This is especially the case if the transaction reduced the insolvency estate because the debtor transferred an asset without receiving adequate consideration. However, even where the debtor has received adequate consideration, a transaction can nevertheless be qualified as detrimental to the creditors if upon opening of insolvency proceedings the consideration is no longer available for the benefit of the creditors (e.g., because it has been spent on wages, electricity, etc.).

If a transaction is determined to have set other creditors not involved in the transaction at a disadvantage, the insolvency administrator has a right to void the transaction and reclaim (“claw back”) transferred assets if additional requirements as set forth in the IC are met. In general, transactions made during a period of three months prior to the filing of an insolvency petition or thereafter are at a particular risk of being voided. During this general preference period the risk of any creditor dealing with the debtor is usually significant if the creditor enters into transactions which are not at arm’s length, if the creditor accepts performance or security to which the creditor is not entitled or if the transaction is made at a time where the debtor’s liquidity issues were already apparent to the creditor. Outside the general preference period, transactions can nevertheless be voided if certain circumstances apply. For gratuitous benefits granted by the debtor to a creditor, for instance, the preference period is four years. Further, where the debtor intended to place its creditors at a disadvantage and where the other party to the transaction was aware of such intent (intentional creditor disadvantaging), transactions made up to ten years before the filing of the insolvency petition can be voided.

In March 2015, the German Federal Ministry of Justice issued a draft bill to improve legal certainty of avoidance actions. The draft especially proposes to limit the administrator’s right to claim for intentional creditor disadvantaging by (i) shortening the maximum claw-back period in many cases from 10 years to 4 years, (ii) requiring an inappropriate (unangemessen) dealing of the debtor, and (iii) increasing the requirements for proving the creditor’s knowledge of the debtor’s intent. The proposed changes to the avoidance rules are currently under discussion.

Pre-Insolvency Restructuring

Typically, long before a company files for insolvency, the shareholders and creditors, including lenders, have undertaken various efforts to prevent an insolvency of the company.

Shareholders often inject additional capital which, if provided as equity, will usually be lost in the event of insolvency if the pre-insolvency restructuring fails. Also, if funds are provided under shareholder loans and the debtor has to file for insolvency, the shareholders are unlikely to be able to recover any such funds because their claims rank behind those of other insolvency creditors. Further, any repayment on shareholder loans and/or the transfer of any assets as security for the loans can be voided by the insolvency administrator, if the payment/transfer took place within one/ten year(s) before the submission of the application to open insolvency proceedings. Lenders that gave additional funds to the debtor in a crisis before the debtor became insolvent may under certain circumstances be liable towards other creditors under tort, if before granting the additional funds the lender did not form its own
opinion on whether the debtor was able to overcome its financial crisis on the basis of a commercially sound business plan. This liability also arises if the lender is able to withdraw funds in the crisis of the debtor but does not do so. Typically, banks request from the company in a financial crisis an audited Reorganization report (“Sanierungsgutachten”) to mitigate this risk.

Another restructuring instrument is a debt-to-equity swap. This is an effective means of preventing the company from becoming over-indebted and at the same time reduces the ongoing financial burden of the company (interest payments, etc.). A lender contributes its claims against the company into its equity and obtains shares in the company in return. From a lender’s perspective, a debt-to-equity swap may be especially attractive when a company faces short-term difficulties while having long-term potential. A debt-to-equity swap poses numerous technical challenges and any debtor or creditor contemplating a debt-to-equity swap should obtain qualified advice. Usually, a debt-to-equity swap is implemented by decreasing the company’s capital followed by a capital increase. The shareholders waive their rights to acquire new shares originating from the capital increase and the lenders contribute their payment claims in return for new shares. This transaction requires a valuation of the lenders’ claims since they may not be contributed at face value, but at their real value only. Correctly valuing the creditors’ claims is one of the main challenges in a debt-to-equity swap and requires specialist advice.

Another challenge is the tax implications that a debt-to-equity swap poses. By virtue of the contribution below face value the company realises a gain which is in principle taxable. If the lenders do not swap all their loans into equity, another issue to consider is potential subordination of the lenders’ continuing claims as shareholder loans. Under certain conditions, claims are exempted from such subordination if a lender acquires shares in a company’s crisis. Lenders contemplating a debt-to-equity swap should seek specialist advice to ensure that they will be able to rely on this exemption. The capital decrease and increase which is typically part of a debt-to-equity swap requires the participation of the current shareholders, who will be diluted in the process. A debt-to-equity-swap may also be used in formal insolvency proceedings (see below).

A distressed company or group of companies may contemplate selling part of its operations to generate liquidity. In such cases, the purchaser needs to consider the possibility of the seller subsequently filing for insolvency. Any purchase from a distressed seller needs to be carefully structured to minimise typical insolvency-related risks, in particular the insolvency administrator’s right to opt for non-performance of a pending purchase contract or to claw back assets transferred. Typically less critical from a legal viewpoint are situations where not the seller, but the target, is in distress. In a distressed target scenario, the purchaser's primary challenge is to realistically evaluate the target’s potential and to determine a reasonable purchase price or negative purchase price, as the case may be. However, the risk of a potential target's insolvency also needs to be considered, in particular when the sale is combined with a carve-out.

Many other tools exist which are often used in pre-insolvency restructurings to prevent an insolvency. Creditors are sometimes willing to agree to a temporary standstill or a (conditional) waiver of some of their claims, possibly with a view to participating in future profits of the debtor after a successful restructuring. Shareholders may agree on a subordination of their claims or issue payment or liquidity guarantees to the debtor or to certain creditors. The debtor may seek to improve its operational business and consider reducing its workforce.
Post-Insolvency Restructuring

Debtor’s management and shareholders may also aim for a post-insolvency restructuring, which is increasingly becoming an option as the ESUG has made debtor-in-possession proceedings easier to be granted. Likewise, the (preliminary) insolvency administrator also can begin preparing a restructuring of the debtor which may be achieved by an asset deal or, alternatively, by an insolvency plan prepared by the (preliminary) administrator or the debtor for a restructuring without liquidation.

As compared to an acquisition in a distressed situation, post-insolvency restructurings have many advantages. The insolvency administrator (or, in debtor-in-possession proceedings, the debtor) has special termination rights which allow him to terminate or renegotiate the terms of disadvantageous contracts and reduce the debtor’s workforce. In addition, the purchaser faces fewer liability risks. In an asset deal outside the insolvency, the purchaser may be liable: for the seller’s unpaid taxes relating to the acquired business; towards the seller’s creditors, if the purchaser continues to operate the business under the same firm; and for unpaid salaries and other benefits owed by the seller to transferring employees. These risks either do not apply in insolvency, or are at least reduced.

Restructuring by Asset Deal

If the insolvency administrator comes to the conclusion that the debtor’s business or parts of it can be continued by a third party investor, he will seek the investor's agreement to acquire the business (or parts of it) by way of an asset deal. Any remaining assets are liquidated.

The insolvency administrator faces several challenges. First of all, he has to identify those parts of the business that can be continued, then find a suitable buyer and finally obtain the creditors’ consent. There is also only a small window for closing the deal before the financial situation of the debtor further deteriorates and the business has to be liquidated altogether. Since the creditors’ assembly usually does not meet sooner than two or three months after the opening of the insolvency proceedings, the insolvency administrator often needs to request from the insolvency court permission to appoint a preliminary creditors’ committee to rule on the sale of the debtor’s business (or parts thereof). In addition to the approval of the creditors’ committee, each creditor holding title to an asset that would be transferred to the buyer has to agree to such transfer, as must the other party to any contract that would need to be transferred.

The employees belonging to the transferred business automatically migrate to the purchaser by operation of German Civil Law. Thus, an overstaffed business may deter potential investors. There are several options to deal with this issue. German insolvency law facilitates a termination of employment amongst the workforce, and the insolvency administrator may use this option to decrease the labour force before closing the asset deal. Another model often used is transferring the employees to a separate entity for professional reorientation. This is possible only with the consent of both the employees and the works council (if applicable). In practice, the employees will often grant their consent if a potential investor makes its acquisition of the debtor's business conditional upon the employees transferring to the reorientation entity. If the business is sold to the investor after all employees have transferred to the reorientation entity, the employees will not transfer automatically, but instead the investor can extend job offers to selected employees. While decreasing the workforce prior to an asset sale is thus possible and often works in practice, it needs to be done correctly to avoid unwanted transfers of employees.

Normally, it is already the preliminary insolvency administrator who starts looking for, or is approached by, potential investors, and sometimes the preliminary insolvency administrator agrees with an investor on the terms of a sale of the business prior to the opening of formal
insolvency proceedings. In such cases, the purchase contract is often made conditional upon the opening of formal proceedings and the consent of the creditors to the transaction to minimise the risks for the preliminary insolvency administrator and the investor.

Restructuring by Insolvency Plan

The insolvency plan regime is a flexible tool which allows the stakeholders to deviate from certain provisions and principles of the IC. One major difference between insolvency plan proceedings and regular insolvency proceedings is the option, with the creditors’ consent, to grant the debtor full or partial discharge from its residual debt. A restructuring by insolvency plan may enable the debtor to continue the operation of its business without dissolution and to transfer the (entire) business to a new entity. This is particularly attractive – also from a creditor's perspective – when the debtor is a listed company and/or its business depends on non-transferable licenses, permits or other entitlements, or on contractual rights the transfer of which would require the consent of a third party.

Discharge of the debtor's residual debt can be tailored to the debtor’s individual situation and it can, e.g., be combined with standstill arrangements. Another option is to make the discharge conditional upon the fulfilment of certain requirements by the debtor so that the creditors would participate in a liquidation of the debtor with their original claims amounts if the restructuring eventually fails. The insolvency plan does not need to be approved by all creditors. Instead, the creditors are divided into several groups. All of these groups need to approve the insolvency plan with a majority vote (in number and amount) within each group being sufficient. Dissenting groups may under certain conditions be disregarded, in particular if their dissenting is economically unreasonable (cram-down).

In insolvency plan proceedings preferred lending may be made available to certain lenders who finance the debtor's restructuring. In the case of an eventual failure of the restructuring and a subsequent liquidation of the debtor, the claims of such preferred lenders will rank not only prior to the insolvency creditors but also prior to creditors with new claims stemming from the time after the insolvency plan became effective.

Nevertheless, prior to the ESUG, though applied in some landmark restructurings (e.g., Herlitz, Senator Entertainment, Ihr Platz, Garant Schuh+Mode, Märklin, Karstadt), the insolvency plan had not been widely used. One obstacle in applying this restructuring tool was the blocking potential of dissenting individual creditors: “Free riders” could try to prevent the insolvency court from approving the plan by arguing that without it (i.e., in the event of a liquidation and dissolution of the debtor) they would receive a higher dividend on their claims. Once the insolvency court had approved a plan, creditors could appeal the approval and even further appeal a decision of the appellate court. The ESUG has now diminished such blocking potential by restricting legal means:

- Creditors may no longer seek to prevent the court from approving the insolvency plan if funds are set aside to compensate creditors for any disadvantage they suffer due to the plan being approved.
- Appeals from the court’s approval of the plan may be dismissed (subject to the creditor’s right to claim damages outside the insolvency proceedings) if the interest in the plan becoming effective immediately prevails over the creditor’s potential damage; a further appeal is permissible in exceptional cases only.

Another reason for the minor role the insolvency plan played in German restructurings was the inability to bind the debtor’s shareholders to any such plan. Any debt-to-equity swap required the shareholders’ consent; even a decision to continue the operations of the debtor required a corresponding shareholders’ resolution. As a consequence, restructurings could
be blocked not only by dissenting creditors but also by shareholders. Even if the shareholders agreed to a debt-to-equity swap, swapping creditors ran the risk that statutory capitalisation rules potentially required them to make additional cash contributions to the company’s capital if it later turned out that the swapped claims had been misvalued.

Now, after the ESUG has come into effect, shareholders may be included in an insolvency plan. If so, they will be entitled to vote on the plan as a group, and can be crammed down like any other creditors’ group. The plan may include a shareholders’ resolution to continue with the company’s business and also provide for a debt-to-equity swap, even if the shareholders do not consent. Moreover, statutory capitalisation rules applying to swaps by insolvency plans will be mitigated: If the plan has been approved by the court any subsequent claims against the swapping creditor to make cash contributions are excluded. Hence, swapping creditors no longer bear the risk of becoming obligated to make future cash contributions because the swapped claims had been misvalued.

Insolvency plans may be prepared by the debtor itself – prior to the filing, during the preliminary proceedings or after the opening of the proceedings – or by the (preliminary) insolvency administrator/custodian. Individual creditors are not entitled to prepare an insolvency plan; however, the creditor’s assembly may instruct the administrator to do so.

Conclusions and Additional Observation

German insolvency law is highly complex and a lot of experience and knowledge is required to navigate through it. Very popular misconceptions are, for instance, that the insolvency administrator is, like a notary public, required to look out for the interests of all participants in an insolvency, including a potential investor, or that all claims established with the consent of a preliminary insolvency administrator have to be fully satisfied by a debtor. Thus, when dealing with an insolvent company, it is very important to understand the (preliminary) insolvency administrator’s role and the scope of his authority.

In addition, German insolvency law is in a constant state of flux, which adds to its complexity. By the ESUG having come into effect on March 1, 2012, the first package of the reform of German insolvency law has been enacted. A second package, amending the rules applicable to the insolvency of individuals, has come into effect on July 1, 2014. The third package, dealing with group insolvencies, is still to come. Also, the introduction of special rules for protection of licences, as well as avoidance rules, continue to be discussed. Thus, in a few years or even only months, the IC may be subject to further substantial changes, giving the debtors and creditors more options to re-strengthen the business of the debtor.
Germany

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Overview and Introduction

In Hong Kong, the main objectives of the insolvency and bankruptcy law are to protect and maximise the value of the insolvent company and to collect and realise the assets of the bankrupt individual for the benefit of all creditors. Generally, the term “insolvency” applies to companies, whereas the term “bankruptcy” applies to individuals.

The bankruptcy legislation was substantially overhauled and culminated in what was perceived to be a more modern bankruptcy regime, which came into operation on 1 April 1998. The insolvency legislation, however, is in great need of an update and reorganisation.

Applicable Legislation

The principal legislation governing insolvency and bankruptcy in Hong Kong consists of the Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap 32) (“CWUMPO”), the Companies (Winding-Up) Rules (Cap 32H), the Bankruptcy Ordinance (Cap 6) and the Bankruptcy Rules (Cap 6A).

Voluntary Arrangement and Interim Order

Voluntary arrangements are available to both bankrupts and non-bankrupts. The voluntary arrangement procedure allows the debtor to apply for an interim order, which provides the debtor with a “breathing space”, i.e. a moratorium, for the debtor to reorganise his financial affairs and to come up with an arrangement that is acceptable to his creditors. During this “breathing space”, no bankruptcy, enforcement or other proceedings can be brought or continued against the debtor without the leave of the court.

Personal Bankruptcy

Hong Kong’s bankruptcy system is governed by the Bankruptcy Ordinance and the Bankruptcy Rules.

Jurisdiction of the Bankruptcy Court

A creditor may file a bankruptcy petition against a debtor if:

- The debtor is domiciled in Hong Kong;
- The debtor is personally present in Hong Kong on the day on which the petition is presented; or
- At any time within a period of three years ending with the day of the presentation of the petition, the debtor has been ordinarily resident or has had a place of residence in Hong Kong, or has carried on business in Hong Kong.

These provisions reflect the international commercial environment of Hong Kong and the high mobility of a large proportion of the working population.
Bankruptcy Petition

There are two situations under which a creditor may present a bankruptcy petition against a debtor:

1. The creditor has served on the debtor a statutory demand and the debtor has not complied with the demand nor set it aside within three weeks from the date the demand was served on the debtor; or
2. The execution of a judgment debt against the debtor by the petitioner has been returned unsatisfied, in whole or in part.

The debtor may also present a petition for a bankruptcy order against himself on the payment of a deposit to the Official Receiver.

There are advantages that a debtor may enjoy by presenting a bankruptcy petition, including:

- If a bankruptcy order is made, the debtor gives up virtually all his property in return for being freed from the accumulated burdens of his debts and for being given a chance, in due course, to make a fresh start;
- The debtor avoids the inconvenience and dissipation of resources caused by multiple executions and other forms of enforcement process; and
- All the creditors are dealt with in the most equitable way through a collective process, whereby such assets as the debtor has for distribution among his creditors will be shared among them pro rata in proportion to the debts that are owed.

Despite the advantages, the court has discretion to dismiss the debtor’s petition. The court will do so if it is of the view that the petition is an abuse of the process.

Commencement of Bankruptcy

The bankruptcy of the person against whom a bankruptcy order has been made commences on the day on which the order is made.

Upon the making of the bankruptcy order, the Official Receiver is the trustee of the bankrupt and takes all steps to protect the bankrupt’s estate.

In addition, all property belonging to or vested in the bankrupt at the commencement of the bankruptcy vests in the Official Receiver or, if a person other than the Official Receiver is appointed as the trustee, such appointed trustee.

The bankrupt is under a duty to deliver up possession of any part of his estate that is in his possession or under his control to the Official Receiver or appointed trustee. In addition:

- Where the property of the debtor includes things in action, such things shall be deemed to have been duly assigned to the trustee;
- A variety of persons, including bankers, lawyers and employers of a bankrupt who possess property of the bankrupt, must pay and deliver all such property to the trustee that they are not entitled to retain against the debtor; and
- The debtor must sign all necessary documents and instruments for selling any property outside Hong Kong for the benefit of creditors.
Discharge from Bankruptcy

A fundamental objective of the legislation is to enable bankrupts to make fresh starts after discharging their obligations under the bankruptcy laws.

The effect of a discharge is that the bankrupt is released from all bankruptcy debts, which include:

- Any debt or liability to which he is subject at the commencement of the bankruptcy; and
- Any debt or liability to which he may become subject after the commencement of the bankruptcy (including after his discharge from bankruptcy) by reason of any obligation incurred before the commencement of the bankruptcy.

It is noted, however, that the legislation provides that, as a condition of granting the discharge, the court may order the bankrupt to continue to make contributions to the estate in such amount and for such period as the court considers appropriate, up to a period of eight years from the date of the bankruptcy order.

There are two types of discharge under the bankruptcy regime:

- **Automatic discharge from bankruptcy**. The legislation provides for the bankrupt to be discharged automatically from bankruptcy after the expiry of four years for a first time bankrupt or five years for a repeat bankrupt, as measured from the date of commencement of the bankruptcy. However, the trustee in bankruptcy or a creditor of the bankrupt may apply to the court to object to the automatic discharge under certain grounds and therefore postpone the automatic discharge.

- **Early discharge from bankruptcy**. This permits the bankrupt to apply to the court for a discharge at any time before the expiry of the aforesaid period or, if he has been previously adjudged bankrupt, not less than three years after the date of the bankruptcy order.

These mechanisms for discharge are intended to give greater incentive to the bankrupt to cooperate with the trustee because a failure to cooperate could result in the trustee objecting to a bankrupt's discharge. In addition, if the bankrupt fails to cooperate, the automatic discharge may be suspended by order of the court.

Corporate Restructuring and Insolvency

Reorganisations, Restructurings and Work-Outs

There is no Chapter 11 or voluntary administration procedure available under the CWUMPO in Hong Kong, so work-outs are essentially contractual arrangements that are mutually agreed between the debtor company and its financial creditors without any need to involve the court. The aim is to achieve the continuation of the company’s business without the need to commence winding-up proceedings.

Terms of the Restructuring or Work-Out

The terms of the restructuring or work-out arrangement are set by the parties involved through commercial negotiation and often involve reorganisation of the company’s business.
Success requires all creditors to agree on the terms of the restructuring to prevent any dissenting creditor from commencing winding-up proceedings or seeking to enforce any judgments already obtained.

Debt Rescheduling

Restructurings or work-outs often involve the rescheduling of debts, whether matured or otherwise, of the company facing financial difficulties. Often the company will seek to convince creditors not to demand or insist on full payment of debts. Besides deferring payment, part of the principal and/or part or all of the interest may be reduced, cancelled or waived after negotiation.

Multiple-Bank Restructurings

The restructuring of large corporations often involves multiple bank entities, which typically constitute the major creditors.

Generally, banks will be prepared to embark on a restructuring only if the prospect of eventual recovery is greater than it would be if the company were placed in liquidation. Cooperation and a recognition of shared interests are integral to a successful restructuring or work-out process.

The Hong Kong Monetary Authority and The Hong Kong Association of Banks have issued non-statutory guidelines on how member banks should deal with multiple-bank restructurings.

Corporate Insolvencies

In Hong Kong, there are three types of liquidation: members’ voluntary liquidation, creditors’ voluntary liquidation and compulsory liquidation.

Solvency is usually assessed on a cash-flow basis for going concerns, that is, the company can pay its debts as and when they fall due. However, after the liquidation process, solvency is assessed on an assets basis, i.e. realisable assets less known liabilities. If the result is positive, the liquidation will be solvent, the creditors will receive a complete recovery and there will be a return to shareholders. If it is negative, the liquidation is insolvent and there will be a shortfall of assets, resulting in a shortfall to creditors and no return to shareholders.

Members’ Voluntary Liquidation

This is available only where the company is solvent. The directors must swear a statutory declaration of solvency and creditors must be paid in full within 12 months. As the company is solvent, it is the members who control the conduct of the winding-up.

Creditors’ Voluntary Liquidation

A creditors’ voluntary liquidation occurs where a company in its general meeting passes a special resolution to place the company into voluntary liquidation and where no statutory declaration of solvency has been sworn by the directors.

The resolution is usually passed on the basis that the company cannot, by reason of its liabilities, continue its business. As the company is not solvent, the creditors have control of the liquidation.

At the same time as summoning the shareholders’ meeting, the company must give notice of a meeting of creditors via an advertisement in the Government Gazette, and in one Chinese-language and one English-language newspaper. The directors must also lay out a full
statement of the company’s affairs as well as a list of creditors (with an estimated amount of their claims) before the meeting.

At the creditors’ meeting, the creditors nominate their liquidator or joint liquidators and may establish a committee of inspection of not more than five persons. The role of the committee of inspection is both to assist and supervise the liquidator in the conduct of the liquidation.

The Court’s Role in a Voluntary Liquidation

Both members’ voluntary and creditors’ voluntary liquidations are subject to the court’s supervisory jurisdiction, which means that stakeholders such as the liquidator, creditors or shareholders may apply for the court’s directions as to the conduct of certain aspects of the liquidation. But these liquidations can proceed with little or no guidance from the court, particularly where the liquidation is solvent. Voluntary liquidations can therefore provide an opportunity for a more managed liquidation process.

Compulsory Liquidation

A company may be wound up by the court on a number of grounds, most often in an insolvency situation because it is unable to pay its debts. There is also a broad discretionary power under which the court can order a company to be wound up where it is just and equitable to do so.

Application to the Court

The application submitted to the court to wind up a company may be made by a creditor, a shareholder or the company itself. This is done by way of a winding-up petition.

Once the petition is issued, the winding-up of the company is deemed to have commenced. This is a key date to remember in the application of numerous legislative provisions relevant to the insolvency regime.

Uncontested Cases

In a straightforward, uncontested case, events usually proceed swiftly, concluding with a winding-up order against the company.

Complex Cases and Restructuring Attempts

In more complex cases, for instance, where there is a “White Knight” who attempts to rescue a company that is on the brink of insolvency, adjournments of the winding-up petition are often sought to enable the company to advance restructuring negotiations.

The Court’s Supervisory Role

Throughout the administration of the compulsory winding-up of a company, the court maintains a supervisory role. The court’s approval is also required for certain matters, including the appointment of provisional liquidators and liquidators who act as officers of the court in the management of the company during the compulsory liquidation or restructuring process.

Powers of a Provisional Liquidator

When a winding-up petition has been presented to the court, the court may order the appointment of one or more provisional liquidators (either the Official Receiver or private insolvency practitioners) if the assets of the company are in danger or there has been an allegation that the personnel in control of the company have misappropriated the company’s assets.
The purpose of appointing a provisional liquidator is to maintain the status quo of the company and preserve its assets and records. The order of the court appointing the provisional liquidator will specify the functions to be carried out in conjunction with the powers afforded to the provisional liquidator under the CWUMPO and the Companies (Winding-Up) Rules.

**Powers of the Directors Cease**

Hong Kong case law states that, in the instance of a winding-up petition on just and equitable grounds, the appointment of a provisional liquidator operates to transfer to him the powers of the directors who thereby cease to be the company’s authorised agents.1 This means that, upon the appointment of the provisional liquidator, the managerial and operational powers of the directors in the company are vested in the provisional liquidator. The directors retain a limited residual power (for example, to resist the winding-up petition) but it is not of a managerial nature. Decisions regarding the operation of the company are vested in the provisional liquidator from the time of his appointment, and the directors’ powers are suspended at that time.

**Priority of Claims**

In insolvency proceedings, the assets available to the company are usually insufficient to satisfy all creditor claims. As a result, the priority or order of ranking of different claims is of utmost importance.

In court liquidations, claims that are not secured are distributed in a statutory prescribed order that, in brief, is as follows:

- Costs and expenses properly incurred in preserving, realising or gathering the assets of the company, including the liquidator’s remuneration and disbursements;
- Preferential creditors (e.g. certain debts due to employees or the government);
- Creditors secured by a floating charge;
- Ordinary unsecured creditors (including any shortfall arising from secured creditors after realisation of their security); and
- Shareholders.

Secured creditors stand outside of the above priority of payments as they are entitled to look to the proceeds of their security.

**Pari Passu Principle of Distribution**

A general principle of *pari passu* distribution is applied; namely, ordinary creditors should rank equally among themselves.

**Set-Off**

Hong Kong has yet to enact legislation specifically applicable to set-offs in corporate insolvency. Notwithstanding this, set-off pursuant to the Bankruptcy Ordinance (section 35) applies where, before the company goes into liquidation, there have been mutual credits, mutual debts or other mutual dealings. The mutual dealings do not have to be in relation to the same transaction between the parties, although the mutual dealings must be between

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1 Boldwin Construction Co. Ltd [2002] 1278 HKCU.
the same parties. In addition, mutual dealings are not restricted to debts incurred under contracts.

In such circumstances, an account is taken of what is due from each party to the other in respect of the mutual dealings and the sums due from one party are set off against the sums due from the other. The effect of the existence of a set-off in a liquidation is that only the net balance owed will be paid to (or due from) the liquidator, and only one sum will be owed.

The purpose behind section 35 is to do justice between the parties. If there were no such thing as a set-off in insolvency, it would mean a creditor was bound to pay his debt to the company in full and at once, but in relation to the debt owed to him by the company, he would have to enter proof in the liquidation and would be entitled to receive only a dividend from the liquidator months or even years later. In other words, to the extent that a set-off is available, the creditor gets 100% on the relevant amount and is in a better position than unsecured creditors who are reliant on a pari passu distribution.

Clawback and Recovery Mechanisms

In all forms of liquidation, liquidators are empowered to investigate the affairs of a company and seek redress from the court where it considers assets belonging to the company have been dissipated. If an order is made by the court, the relevant directors, company officers or creditors may be required to repay or restore the property to the company, or contribute to the assets of the company, as the court considers appropriate. Below are some examples of possible offences that liquidators may investigate.

- **Unfair preference.** The liquidator may challenge creditors who have received payments from the company and may have been preferred against other creditors within six months of commencement of the liquidation. The six-month period is increased to two years in the case of associates, which is broadly defined to include transfers between the company and its directors.

- **Disposition of property with intent to defraud creditors.** This is voidable at the instance of the person prejudiced by the disposition, except if the property is disposed of for valuable consideration and in good faith to any person who has not received, at the time of the disposition, notice of the intent to defraud creditors.

- **Disposition after commencement of compulsory liquidation.** These dispositions or payments are void and the recipients of these funds or assets have to return the funds or assets to the liquidator, unless a validation order has been made by the court.

- **Fraudulent trading.** Where the business is carried on with the intent to defraud creditors or for any other fraudulent purpose.

- **Misfeasance.** Where directors have breached their fiduciary duties to the company or have misapplied or retained property of the company for their personal benefit.

At present, there is no legislation in Hong Kong that prohibits insolvent trading or the incurring of a debt by a company at a time it is unable to pay its debts as they fall due.

Disclaimer of Onerous Contracts

Where a company has entered into unprofitable contracts or its assets include land burdened with an onerous covenant, shares or stock in companies, or unsalable property, the liquidator may, with leave of the court, surrender or disclaim that contract or property within 12 months after the commencement of liquidation. The disclaimer is binding on the
rights and interests of the company and will release the company and the property of the company from liability as far as is necessary.

Court-Approved Arrangements and Reconstructions

The court also has jurisdiction to sanction a scheme of arrangement if a compromise or arrangement is proposed between a company and its creditors or any class of them, or between the company and its members (or any class of them) by the application of the company or any creditor or member of the company.

Absence of a Moratorium

One of the major problems with the CWUMPO is the absence of any formal moratorium available to the insolvent company. As a result, unless and until a scheme has been sanctioned by the court, which in a large corporate group structure may take many months, no member or creditor will be bound by the terms of the scheme and the insolvent company is not protected in any way from new litigation or enforcement procedures from creditors of the company.

In practice, the period between the presentation of a winding-up petition and the making of a winding-up order provides a moratorium period, otherwise not available under the current legislative regime, to conduct restructuring negotiations. The reason for this is the opportunity afforded to the company (and any creditor and person obligated to contribute to the assets of the company) to apply to the court for a stay of proceedings at any time after the presentation of a winding-up petition and before a winding-up order has been made.²

Requisite Elements for a Scheme to Succeed

The aim of a scheme of arrangement is always to achieve for the creditors a better pay-out than they would receive in a winding-up distribution. To succeed, the scheme must be approved by at least 75% in value and 50% in number of the creditors voting at the relevant scheme meetings, and must be sanctioned by the court. Once sanctioned, the scheme is binding on all creditors. For this reason, the support of the larger creditors to the scheme at an early stage is essential.

Creditors may choose to take a cut in the amount owed to them on the basis that they will receive some form of financial return and, in some cases, shares in the newly restructured company, which is considered to be better than receiving a minimal payment, if any, on a winding-up of the company.

Out-of-Court Mechanisms

Receivers may be appointed by the court or in accordance with the terms of a debenture or charge. The power of a receiver will normally include the powers to collect, sell and manage the charged assets to protect the interests of the debenture holder. A receiver appointed out of court may apply to the court for directions in connection with the performance of his functions.

Conclusions and Additional Observations

As mentioned at the outset, the insolvency and bankruptcy legislation in Hong Kong requires an in-depth review. Various parts of the legislation need to be updated and the various pieces of legislation need to be consolidated for easier handling.

² Section 181 of the CWUMPO.
Improving the Corporate Insolvency Law

The Hong Kong government is currently considering reforms to improve Hong Kong’s corporate insolvency law. The proposed improvements are set out in the Companies (Winding-Up and Miscellaneous Provisions) (Amendment) Bill 2015 and cover a wide variety of areas, including transactions at an undervalue, the appointment and powers of provisional liquidators and liquidators, unfair preferences and investigation during winding-up.

Corporate Rescue Bill

The Hong Kong government is considering implementing a statutory corporate rescue procedure. The proposed legislation envisages a “provisional supervision” by an appointed third party, the provisional supervisor – similar to voluntary administration in the United Kingdom or Australia. The provisional supervision mechanism is intended to complement and enhance the existing restructuring arrangements in Hong Kong.

The provisional supervisor would take temporary control of the company, consider options for rescuing the company and if applicable, prepare a proposal for a voluntary arrangement which would bind the company, its officers, members, the provisional supervisor and all relevant creditors. It is also intended that the statutory corporate rescue procedure would involve predominantly out-of-court arrangements to save time and costs.

A significant feature of the proposed legislation is the introduction of a formal moratorium once the provisional supervision process commences. During the moratorium, no application for winding-up can be commenced or continued, receivers cannot be appointed and no proceedings or other process may be commenced or continued.

The aim of the statutory corporate rescue procedure is to provide an option for companies in short-term financial difficulties to initiate the procedure with a view to turning around and reviving its business instead of having to face a winding-up. This will also achieve a better return for the creditors of the company than in the case of a winding-up.

These proposed corporate rescue procedures are an important development for Hong Kong. The Hong Kong government conducted a public consultation in 2009-2010 on these proposals, and published its conclusions in July 2010. It has also indicated that it aims to complete the drafting of the relevant bill in 2016. The proposed legislation will significantly improve the prospects of rescuing insolvent companies in Hong Kong.

Funding in Insolvency Proceedings

There are no specific provisions under the Hong Kong legislation for lending in insolvency proceedings. However, it is possible for a company to obtain financing from a willing lender when it is under insolvency proceedings pursuant to contractual arrangements. It is not uncommon for a liquidator to obtain financing from creditors to conduct investigations or litigation.

Recent case law also indicates that the CWUMPO enables a liquidator to sell or assign a cause of action to a litigation funder. However, this power of sale only applies to causes of action vested in the company, rather than the liquidator personally. It is expected that the litigation funding industry in Hong Kong will continue to grow.

Priority Ranking for Post-Liquidation Borrowing

Where a lender is willing to provide new money for the purpose of preserving and realising the assets of a company, such post-liquidation borrowing of the company may amount to an
expense properly incurred by the liquidator that will rank in priority to any pre-liquidation debts.

In addition, although the general principle of *pari passu* distribution applies to unsecured creditors, the legislation provides that where a creditor has undertaken a substantial risk when giving the liquidator an indemnity for costs in litigation, the court may grant the creditor in question a greater share of the particular assets recovered than would normally be received under the *pari passu* principle.

**White Knight**

A “White Knight” may also finance a company following a scheme of arrangement or restructuring of the company by acquiring or paying off part of the distressed debt.

In addition, during the restructuring process, banks and financial creditors will often agree to extend the credit lines of the company before the court sanctions the scheme so that the company may continue its restructuring attempts.

**Impact of Credit Derivatives on Corporate Insolvencies**

The development and growth of the credit derivatives market have had, and will continue to have, an increasing impact upon corporate insolvencies and restructurings.

As a result, when a restructuring is contemplated, debtors and their advisors are encouraged to consider the potential presence of credit derivative products (e.g. credit default swaps) and all their possible consequences. A potentially important practical issue may be whether a credit event has occurred at any point in the restructuring. The identity of those who may ultimately bear the credit risk of the debtor may also require investigation because the facts may be unclear on the face of the available documentation.

**Hong Kong**

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Overview and Introduction

This Guide discusses various formal administrative procedures available to insolvent companies. The main objectives of Hungary’s insolvency law are to protect and maximise the value of the insolvent company for the benefit of all creditors and also to reverse the company’s financial position to one of solvency if possible.

As a member of the European Union, the Republic of Hungary continues to implement EU regulations relating to restructuring and insolvency.

Applicable Legislation

The legislation governing insolvency proceedings is Act XLIX of 1991 on Bankruptcy Proceedings and Liquidation Proceedings (the “Bankruptcy Act”), while the legislation governing the winding-up of a solvent company is Act V of 2006 on Public Company Information, Company Registration and Winding-up Proceedings. Act V of 2013 of the Civil Code (the “Civil Code”) regulates the foundation, organisation and operation of business associations with a registered office in Hungary; the rights, obligations and responsibility of the founders and members (shareholders) of business associations; and the transformation, merger and demerger of business associations, as well as the winding-up of such associations without legal succession.

Corporate Restructuring and Insolvency

As a general rule, the Bankruptcy Act applies to economic operators (mostly companies) (“companies”) and their creditors regarding bankruptcy and liquidation proceedings.¹ The Bankruptcy Act does not apply to individuals. The provisions of the Bankruptcy Act apply to associations and foundations if special legislation pertaining to those entities does not provide otherwise.

The Bankruptcy Act covers bankruptcy proceedings and liquidation proceedings.

Meanings of “Bankruptcy” and “Liquidation”

In a “bankruptcy proceeding” the debtor is granted a moratorium to negotiate and enter into debt restructuring agreements with its creditors (“bankruptcy”).

“Liquidation” is the proceeding aimed at providing satisfaction to the creditors of an insolvent debtor upon its dissolution and termination of its corporate existence (“liquidation”).

All assets held by the company under a bankruptcy or liquidation proceeding at the time of the opening of the proceeding, as well as all assets acquired during the proceeding, are the subject of the bankruptcy or liquidation proceeding. The assets of an economic operator comprise all assets that it owns or controls.

Bankruptcy and liquidation proceedings are non-judicial proceedings conducted – as a general rule – by the tribunal (the “tribunal”) of competence and jurisdiction by reference to the debtor’s registered office of record on the day when the request for opening the proceedings was submitted. A request for the opening of bankruptcy proceedings submitted

¹ In addition to companies, the Bankruptcy Act applies to other legal entities, e.g. public-benefit organisations, law offices, European public limited liability companies, European cooperative societies, water management companies and forest management associations. Special rules may apply to certain of these entities.
at other courts will be automatically refused – or if a proceeding has been opened, the progress will be terminated – and will be transferred to the competent court.

**Bankruptcy**

Bankruptcy can be initiated at the request of the debtor.

**Debtor’s Petition for Bankruptcy**

The debtor – through its mandatory legal representative – may submit a petition if in possession of the prior consent of the supreme body of the debtor exercising founders’ (shareholders’) rights. In the case of companies with a sole shareholder, the petition may be submitted by the shareholder at his own discretion. Employees and trade unions, as defined in the Hungarian Labour Code, or the competent workers’ councils (shop stewards) must be duly informed when such a petition is filed.

The petition may be submitted electronically on a standard template form prescribed in specific legislation.

**Commencement of the Bankruptcy Procedure**

The bankruptcy proceeding opens on the day on which the final ruling of the tribunal ordering the bankruptcy procedure is published in the Hungarian *Company Gazette* (the “Commencement Date”).

**Debtor’s Petition for Bankruptcy – Temporary Moratorium**

Upon the debtor’s request for the opening of a bankruptcy proceeding, the tribunal provides – within one working day – for the publication of the request in the *Company Gazette*. The debtor is entitled to a temporary moratorium from the date on which the request is published in the *Company Gazette*.

**The Temporary Moratorium and the Moratorium**

The objective of the temporary moratorium and moratorium (hereinafter referred to collectively as the “moratorium”) is to preserve the assets under bankruptcy protection with a view to reaching a compromise with the creditors. During the moratorium the debtor, administrator, financial institutions maintaining the accounts and creditors must refrain from taking any measure contrary to the objective of the moratorium.

The moratorium is effective from the Commencement Date and expires at 00:00 hours on the second working day after a 120-day period following publication in the *Company Gazette*.

**Registration of the Claims**

The creditors must register claims arising before the Commencement Date within 30 days after the Commencement Date, or within eight working days for claims arising after the Commencement Date.

Within five working days following the Commencement Date, the debtor must also directly notify its creditors – in a daily newspaper of national circulation and also on its website (if available) – to register their claims. The registration of claims is subject to a registration fee payable by the creditor to the administrator’s current account.
Debt Restructuring Negotiation with Creditors

The debtor calls a meeting of creditors within a 60-day period following the time of the opening of bankruptcy proceedings for debt restructuring negotiation. The administrator and all registered creditors must be invited directly, with certain documents attached. Unknown creditors are invited by way of a posted notice.

The debtor – assisted by the administrator – prepares a restructuring plan or debt restructuring proposal to restore or preserve the debtor’s solvency for presentation at the debt restructuring negotiation meeting.

A creditor holds voting rights in the debt restructuring negotiations if:

- It has registered its claim by the deadline specified in the Bankruptcy Act;
- It has paid the registration fee; and
- The claim is registered as acknowledged or uncontested.

The creditors have one vote awarded for each HUF 50,000 of their acknowledged or uncontested claim. Each creditor holding a claim below the HUF 50,000 threshold also has one vote.

A creditor who failed to participate notwithstanding the regular call will be counted as having voted “no”.

Debt Restructuring

Debt restructuring means the debtor’s agreement with the creditors laying down the conditions for debt settlement. In particular, this means: (i) any allowances and payment facilities relating to the debt; (ii) the remission or assumption of certain claims; (iii) the receipt of shares in the debtor company in exchange for a debt; (iv) guarantees for the satisfaction of claims and other similar securities; (v) the approval of the debtor’s programme for restructuring and for cutting losses; (vi) and all other actions deemed necessary to restore or preserve the debtor’s solvency, including the term of the debt restructuring agreement and the procedures to monitor the implementation of the debt restructuring arrangements.

A debt restructuring agreement may be concluded if the debtor is able to secure from the creditors a majority of votes in favour of the agreement. A debt restructuring arrangement applies to all creditors who registered their claims within 30 days after the Commencement Date, even if those creditors are non-consenting creditors who are otherwise entitled to participate in the debt restructuring agreement, and even if those creditors have failed to take part in the conclusion of the debt restructuring agreement. As a formal requirement, debt restructuring agreements have to be in written form.

Creditors who fail to register their claims within the 30-day deadline are not entitled to participate in the debt restructuring, and if the parties conclude a debt restructuring agreement, then the provisions of the agreement will not apply to such creditors. Furthermore, said creditors will no longer be entitled to enforce claims against the debtor that were not registered within the above-mentioned deadline. Notwithstanding the foregoing, if a third-party creditor initiates a liquidation procedure against the debtor, said creditors will be entitled to register their claims during the liquidation procedure, provided that those claims are not barred.

The debtor must notify the tribunal concerning the outcome of the debt restructuring conference within five working days – or 45 days before the expiry of the extended
moratorium – at which time the tribunal delivers its decision on the approval of the debt restructuring arrangement. The tribunal approves the debt restructuring arrangements if the reports, agreements and statements verifying compliance with the above-mentioned regulations are attached.

If the parties fail to conclude a debt restructuring agreement, or if the arrangement is not in compliance with the statutory requirements, the tribunal *ex officio* will dismiss the bankruptcy proceedings and consequently declare the debtor insolvent in liquidation proceedings, at which time the tribunal is obliged to order the liquidation of the debtor.

**Liquidation**

**Applicants for the Opening of Liquidation Proceedings**

Liquidation proceedings are conducted, in the event of insolvency of the debtor, *inter alia*:

- *Ex officio* in the case of an unsuccessful debt restructuring negotiation as part of a bankruptcy proceeding;
- Upon request by the debtor or the debtor’s receiver (in which case legal representation is compulsory);
- Upon request by a creditor (in which case legal representation is compulsory);
- Upon receipt of notice from the court of registry, if it has ordered the liquidation of the company; and
- Upon receipt of notice from a criminal court, if the enforcement procedure aiming for the collection of a fine imposed upon a legal person has failed.

If liquidation proceedings are requested by the debtor, the petition must comply with the relevant provisions applicable to the filing of a bankruptcy petition.

If liquidation is requested by a creditor, the petition must describe the legal title of the debtor’s debt, the date of maturity (due date) and a summary of the reasons why the debtor is deemed insolvent. The foregoing must also be supported by documents attached to the request.

**Commencement of the Insolvency Procedure**

The tribunal investigates whether the debtor is insolvent (as described below) and orders the liquidation by decree if it finds that the debtor is insolvent. The tribunal opens liquidation within 60 days of the receipt of the petition for the liquidation proceedings. The date of the opening of liquidation proceedings is the date of the publication in the *Company Gazette* of the final decree opening the liquidation.

The tribunal declares the debtor insolvent in the following cases:

- Upon the debtor’s failure to settle or contest its previously uncontested or acknowledged contractual debts within 20 days of the due date, and failure to satisfy such debt upon receipt of the creditor’s written payment notice;
- Upon the debtor’s failure to settle its debt within the deadline specified in a final court decision or payment order;
- If an enforcement procedure against the debtor was unsuccessful;
• If the debtor did not fulfill its payment obligation as stipulated in the debt restructuring agreement concluded in the course of bankruptcy or liquidation proceedings;

• If it has declared the previous bankruptcy proceedings terminated; or

• If – in proceedings initiated by the debtor or the receiver (appointed in case of the solvent winding-up of the company) – the debtor’s liabilities exceed the debtor’s assets, or the debtor was unable, and presumably will not be able, to settle its debt(s) on the date on which they are due, and – in proceedings initiated by the receiver – the members (shareholders) of the debtor fail to provide a statement of commitment, following due notice, to guarantee the funds necessary to cover such debts when due.

In the first two cases, liquidation proceedings may not be initiated if the amount of the claim against the debtor (not including interest and similar charges) does not exceed HUF 200,000.

If the debtor is not insolvent, the tribunal issues a priority order terminating the proceedings.

Registration of the Claims

The creditors must register their claims against the debtor within 40 days after the date of publication of the final decree upon opening the liquidation.

Appointment of the Liquidator

If the tribunal finds the debtor insolvent, the tribunal appoints a liquidator simultaneously with the opening of the liquidation.

The appointed liquidator takes control of the debtor from the directors, and only the liquidator is authorised to make any legal statements in connection with the assets of the company.

Creditors’ Committee/Creditors’ Representative

For the purpose of establishing a creditors’ committee or appointing a creditors’ representative, the liquidator convenes all registered creditors within 75 days following the date of publication of the opening of liquidation. The liquidator informs the committee, or the creditors’ representative, at least 15 days in advance – or eight working days in advance in justified cases – of any contracts which exceed the scope of day-to-day operations, upon termination of valid contracts, and upon discarding the debtor’s stocks, provided however, that the committee has the right to comment upon such actions within eight working days (or within five working days in justified cases) of receipt of notice. The liquidator forthwith informs the creditors’ committee (or creditors’ representative) of its reply to such comments, and of the measures taken in consequence. The liquidator sends a financial statement and gives an account of his activities to the committee (or creditors’ representative) quarterly, and then reports on the financial status of the debtor and the costs of liquidation.

Role of the Liquidator

The liquidator analyses the financial standing of the company and the claims against it, prepares an opening liquidation account, estimates the costs of liquidation and sets up a timetable for its implementation. Upon request the liquidator presents the timetable to the creditors’ committee, the creditors’ representative or any of the creditors who are entitled to contest it in court.
The liquidator has powers (with limited exceptions, e.g. tenancy agreements of natural persons) to terminate, with immediate effect, the contracts concluded by the debtor or, if none of the parties rendered any services, the liquidator may rescind the contract.

The liquidator collects the claims of the debtor when due, enforces its claims and sells its assets. With the consent of the creditors, the liquidator may invest the debtor’s property into private limited liability companies, public limited liability companies or cooperatives as non-pecuniary assets (contribution), if it promises to draw a better price this way.

The liquidator disposes of the debtor’s assets through public sales at the highest market price by way of tender or auction. The liquidator may forego the application of these procedures only upon the prior consent of the committee, or if the estimated proceeds are insufficient to cover the costs of sale, or if the difference between the prospective proceeds and estimated costs is less than HUF 100,000. In the last case, the liquidator may utilise other public forms of sale for the purpose of achieving a more favourable result.

Clawback and Recovery Mechanisms

Liquidators have the power to investigate the affairs of the company and to take appropriate legal action against directors or third parties to recover certain assets or undo certain transactions for the purpose of increasing the estate available for distribution to creditors. Creditors also have the right to file a legal action before the court to contest certain contracts concluded by the debtor company for the purpose of increasing the insolvency estate (please see “Actio Paulina” below).

Liability of the Executives

Any creditor or the liquidator – in the debtor’s name – may bring an action during the liquidation proceedings for the court to establish that the former executives of the company failed to properly represent the preferential rights of creditors in the three years prior to the opening of liquidation proceedings. This can be done in the wake of any situation carrying potential danger of insolvency, in consequence of which the company’s assets have diminished, or where the executives failed to provide full satisfaction for the creditors’ claims, or failed to carry out the cleaning up of environmental damages. Any persons with the power to influence the decision-making mechanism of the company will also be considered as executives of the company.

Any executive able to prove that, upon the occurrence of a situation carrying potential danger of insolvency, he took all measures that, within reason, are to be expected from persons in such a position in order to prevent and reduce the losses of creditors, and to prompt the supreme body of the debtor to take action, is not held responsible.

If the court establishes the liability of a former executive, any creditor may bring an action within a 60-day forfeit deadline following the final conclusion of liquidation proceedings. The court will order the debtor’s former executive to satisfy the creditor’s claim to the extent it has not yet been satisfied.

Actio Pauliana

The creditor and, on behalf of the debtor, the liquidator, may file a legal action before the court within 90 days from the time of gaining knowledge of the opening of liquidation proceedings, but not later than one-year from the date of publication, of the opening of the liquidation to contest:

- Contracts concluded by the debtor or its other commitments made within the five years preceding the date on which the tribunal received the petition for opening
liquidation proceedings or thereafter, if intended to conceal the debtor’s assets or to defraud any one creditor or the creditors, and the other party had or should have had knowledge of such intent;

- Contracts concluded by the debtor or its other commitments made within the two years preceding the date on which the tribunal received the petition for opening liquidation proceedings or thereafter, if intended to transfer the debtor’s assets without any compensation or to undertake any commitment for the encumbrance of any part of the debtor’s assets, or if the stipulated consideration constitutes unreasonable and extensive benefits to a third party; or

- Contracts concluded by the debtor or its other commitments made within the 90 days preceding the date on which the tribunal received the petition for opening liquidation proceedings or thereafter, if intended to give preference and privileges to any one creditor, such as the amendment of an existing contract to the benefit of a creditor, or to provide financial collateral to a creditor that does not have any.

If the contest is successful, the provisions of the Civil Code pertaining to invalid contracts will apply.

The liquidator, on behalf of the debtor, is also entitled to reclaim any service the debtor provided within a 60-day period preceding the date when the tribunal received the petition to open liquidation proceedings or thereafter, if it was provided to give preference to any one creditor and if such service is not usually provided under normal circumstances. Prepayment of a debt is, in particular, considered as giving preference or privileges to any one creditor.

**Veil Piercing Rules in Connection with the Liquidation**

In respect of the liquidation of a company under control by a qualified majority (75%), a sole member company or a sole proprietorship, the controlling party or the sole member (shareholder) is responsible, without limitation, for the company’s liabilities not covered by the debtor’s assets during the liquidation proceedings, if the court establishes the unlimited and full responsibility of such controlling party or member (shareholder) for the company’s liabilities pursuant to a petition filed by the creditor during the liquidation proceedings or within a 90-day forfeit deadline following the final conclusion of liquidation proceedings, on account of such controlling party or member (shareholder) having had a history of making unfavourable business decisions from the standpoint of the debtor company.

**Debt Restructuring Agreement in Liquidation**

Following a period of 40 days subsequent to the publication of the opening of liquidation proceedings, the creditors and the debtor may, at any time, conclude a debt restructuring agreement before the final liquidation balance sheet is submitted.

A debt restructuring agreement is deemed valid if supported by the votes of at least half of the creditors with proper entitlement to conclude a debt restructuring agreement in all creditor groups – until their claims are satisfied – provided that the claims of these creditors account for two-thirds of the total claims of those entitled to conclude the debt restructuring agreement.

If solvency of the company is restored through debt restructuring, and the debt restructuring is in conformity with legal regulations, it is confirmed by the tribunal; otherwise the tribunal issues an order of rejection.
The tribunal terminates the liquidation proceedings if all registered debts, acknowledged or uncontested, of the debtor had been satisfied, and if the debtor provides guarantees for contested claims and for the liquidator’s fee.

Rules of the Order of Satisfaction (Priority)

**Secured Creditors**

Secured creditors are entitled to enforce their security and accordingly, subject to the exception of the enforcement costs, will be paid in priority to all other debts to the extent of their security.

In order to ensure the priority ranking, the security holder must report its claim within 40 days. If the security holder fails to report its claim within 40 days, this does not prevent the sale of the pledged property; however, the proceeds must be handled separately and the security holder will be satisfied only if there are sufficient funds remaining after settlement is made according to the general rules of the order of satisfaction.

However, in case of any floating charge, only 50% of the proceeds from the sale of a charged property, less the costs of sale, will be used to satisfy the claims for which such property was charged.

**General Order of Satisfaction**

The debt of the company is satisfied from its assets subject to liquidation in the following order:

(a) Liquidation expenses;

(b) Claims secured by floating charge, up to the value of the pledged property and in consideration of the sums already paid, up to 50% pursuant to priority of the floating charge;

(c) Alimony and life annuity payments, compensation benefits and income supplements to minors, which are payable by the debtor; furthermore, monetary aid granted to members of agricultural cooperatives in lieu of household land or produce, to which the beneficiary is entitled for his lifetime;

(d) With the exception of claims based on bonds, other claims of private individuals not originating from economic activities (in particular claims resulting from insufficient performance or compensation for damages, also including the amount of the guarantee obligations ordinarily expected in the given trade, as calculated by the liquidator), claims of small and micro companies as well as small-scale agricultural producers;

(e) Debts owed to social security funds, taxes and public debts collectable as taxes, repayable government subsidies, repayable state aid and financial aid from European Union and other international resources by virtue of international agreement, as well as public utility charges and condominium maintenance fees;

(f) Other liabilities;

(g) Irrespective of the time and grounds of occurrence, default interests and late charges, as well as surcharges and penalty and similar debts;

(h) Claims (other than for wages and similar benefits, not exceeding six months’ average earnings, that are less than double the prevailing minimum wage or, in the case of
employees whose wages are paid on the basis of performance only, that are less than double the guaranteed salary specified in Subsection (6) of Section 138 of the Labour Code) held by:

(i) Any member (shareholder) of the debtor with majority control;
(ii) Any executive officer of the debtor;
(iii) Any executive employee of the debtor;
(iv) The close relatives of the persons listed in (i) to (iii) above;
(v) A company under the debtor’s majority control; or
(vi) A body (person) benefiting from the debtor’s gratuitous commitments.

The liquidator must register the claims against the debtor which are reported after 40 days, but within 180 days of the publication of the opening of liquidation proceedings. These claims must be satisfied if there are sufficient funds remaining following the settlement of the debts according to the general rules of the order of satisfaction. Failure to observe the time limit of 180 days constitutes a waiver of rights.

Conclusion of Liquidation Proceedings

Based on the final liquidation balance sheet and the proposal for the distribution of assets, the tribunal rules on bearing the costs, the liquidator’s fee, satisfaction of the claims of creditors, the closing of current accounts and abrogation of securities issued by the debtor by way of the central depository. Simultaneously, the tribunal concludes the liquidation and the dissolution of the debtor, along with the dissolution of any subsidiary of the debtor, where applicable.

If a debt restructuring agreement is concluded by the parties, the tribunal confirms the agreement by issuing a decree ruling on the conclusion of liquidation, the fee of the liquidator, the bearing of costs, and on the satisfaction of the claims of creditors excluded from the agreement.

If the debtor is dissolved by liquidation, the portion of assets remaining after the satisfaction of creditors’ claims is distributed among the holders of capital notes in proportion to the subscribed capital shown in the closing balance sheet.

Special Regulatory Regime

A regulatory regime concerning particular companies has been implemented into the Bankruptcy Act. These particular companies comprise two groups:

(i) The first group consists of companies (i) whose settlement of debt, debt restructuring or reorganisation assumes a strong national economical interest or privileged common interest or (ii) whose termination without a successor in a quick and transparent method assumes privileged national economic interests. The new regulatory regime implemented a detailed guideline upon which a company will be declared as a company of preferential status for strategic consideration by the government in the applicable governmental decree. Special provisions, as compared to the more general rules detailed above, apply to these companies, including, *inter alia*, (a) shorter deadlines for exercising rights and obligations under the Bankruptcy Act and (b) that administration of the liquidation process be undertaken only by a non-profit, state-owned entity appointed in the governmental decree.
(ii) The second group consists of companies of preferential status for strategic consideration which also comply with additional requirements, i.e. they are secured by national security protection or they provide public services with international or national significance from a national security, law enforcement, military technology or energy supply perspective. Those companies will also be specifically appointed in a governmental decree by the government of Hungary. The provisions applicable with respect to the first group of particular companies apply to those companies, and the following special provisions also apply.

The tribunal will make an extraordinary moratorium available to these companies from the date the procedure begins until the tribunal decides on the insolvency of the debtor company, which moratorium will ensure the provisional ongoing operation of those companies. During the sale of the assets of the debtor company the common economic interest will be taken into account, and the state liquidator will sell the assets (including movables, real estate and intellectual property) as a working unit. Furthermore, it is not obligatory to organise a public procurement process; the assets of these companies may be sold via closed offering procedures at the discretion of the state liquidator.

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Overview and Introduction

A bankruptcy system has long existed in Indonesia. Formally, it was first introduced in 1905 when the Dutch colonial authorities introduced *Faillisementverordening, Staatsblad* 1905 No. 217 (the “1905 Bankruptcy Rules”). After Indonesia became independent in 1945, the 1905 Bankruptcy Rules remained effective until 1998.

Applicable Legislation

In response to the need for a better bankruptcy mechanism, the government of the Republic of Indonesia has enacted Law No. 37 of 2004, dated 18 October 2004, on Bankruptcy and Suspension of Payment (“Bankruptcy Law”). The Bankruptcy Law consists of 7 chapters and 305 articles. It provides several changes to the Indonesian bankruptcy framework and attempts to provide a legal mechanism for the settlement of debts through the courts in an effective way.

Personal Bankruptcy, Corporate Restructuring and Insolvency

Under the Bankruptcy Law, two types of proceedings may be commenced:

- Bankruptcy proceedings, under which the debtor loses its power to manage and dispose of its assets; and
- Legal debt moratorium or suspension of payment proceedings, under which the debtor, upon request by the creditor or the debtor itself, is given temporary relief to restructure its debts and continue in business, and ultimately to satisfy its creditors.

The provisions on the bankruptcy proceedings are set out in Chapter II (Articles 2 to 215) of the Bankruptcy Law, while the provisions on the suspension of payment proceedings are set out in Chapter III (Articles 222 to 294).

In certain circumstances, bankruptcy proceedings can lead to a suspension of payment proceedings and vice versa. There is no distinction of rules between corporate and individual bankruptcy in Indonesia.

Court-based Insolvencies

The court having jurisdiction over bankruptcy and suspension of payment proceedings is the Commercial Court. The Commercial Court is a specialised court in the commercial field established within the framework of the court of general jurisdiction or *peradilan umum*. Initially, only the District Court of Central Jakarta had a separate chamber designated as the Commercial Court, but now the District Courts of Makassar (Ujung Pandang), Medan, Surabaya and Semarang also have Commercial Courts.

Filing a Bankruptcy Petition

Under the Bankruptcy Law, a debtor who has more than one creditor and who has failed to pay in full one of its debts which is already due and payable can be declared bankrupt by the Commercial Court upon petition of:

- The debtor itself (in the case of voluntary bankruptcy);
- Any of its creditors, whether domestic or foreign;
• The Indonesian Central Bank (Bank Indonesia, if the debtor is a bank) or the Indonesian Capital Market Supervisory Agency (Badan Pengawas Pasar Modal or “BAPEPAM-LK”, if the debtor is a securities company, a stock exchange, a clearing and guarantee agency, or a depository and settlement agency);
• The public prosecutor (if the bankruptcy petition involves the public interest); or
• The Minister of Finance (if the bankruptcy petition is against an insurance company, a reinsurance company, a pension fund, or a state-owned company in the form of a persero).

It is now arguable whether Bank Indonesia, BAPEPAM-LK, and the Minister of Finance still have the authority to file bankruptcy petitions since the supervisory and regulatory functions and roles of the three bodies were moved to the Financial Services Authority (Otoritas Jasa Keuangan) as of 31 December 2012 (for BAPEPAM-LK and the Minister of Finance) and 31 December 2013 (for Bank Indonesia).

Commencement of Bankruptcy Proceedings

The Bankruptcy Law requires that a bankruptcy petition must be filed before the Commercial Court having jurisdiction over the debtor’s legal domicile. If the debtor is a legal entity, the legal domicile of the debtor is that which is stated in its articles of association. If the debtor is not domiciled in the Republic of Indonesia, the petition must be filed with the Commercial Court having jurisdiction over the legal domicile of the debtor’s office where it carries out its business in Indonesia. In other words, a branch office or factory establishment could be served with a bankruptcy petition.

Court Hearings

At the latest three days after the bankruptcy petition is registered, the Commercial Court will study the bankruptcy petition and schedule the first hearing. The first hearing must be held not later than 20 days after the registration date. Upon request of the debtor, the court may postpone the first hearing until at the latest 25 days after the registration date. In recent practice, the court, after registering bankruptcy petitions, immediately issues a summons to the debtor and its creditors, including the petitioning creditor(s) and other creditor(s) mentioned in the bankruptcy petition to attend the court hearing. The summons is physically delivered to the parties by the court’s bailiff unless the party is domiciled in another country or the domicile/dwelling place of the party is unknown. The summons will only be deemed properly served to the debtor if it reaches the debtor at least seven days before the court hearing.

Pending the court decision on the bankruptcy petition, any creditor may petition the court to put an attachment over a part of, or all of, the debtor’s assets and to appoint a temporary curator (which is akin to a receiver or judicial manager). Theoretically speaking, the court is likely to grant an attachment order if there are reasonable grounds for believing that the debtor will dispose of its assets to avoid subjecting them to the bankruptcy procedure (if the petition is successful). The assets subject to the attachment order cannot be transferred, encumbered or leased by the debtor. In granting the attachment order, the court may require the petitioning creditor to provide security to the court.

The decision on the petition for the declaration of bankruptcy must be rendered by the court within 60 days after the date the petition is registered.
Appeal Process

The court’s decision on the bankruptcy petition can be appealed to the Supreme Court by the debtor, any of the petitioning creditor(s), or any other creditor(s) by filing a request for cassation (kasasi), together with a memorandum of cassation containing the reasons for filing the request, with the Clerk of the Commercial Court within eight days after the decision is rendered. Within two days after the request for cassation is filed, the Clerk of the Commercial Court must deliver a copy of the request for cassation and the memorandum of cassation to the other party(ies) to give them a chance to file a response to the request for cassation (which in practice is called a “counter-memorandum of cassation”) within seven days after the date they receive the copy of the request for cassation and the memorandum of cassation. Subsequently, the Clerk of the Commercial Court must deliver all documents relating to the request for cassation to the Supreme Court within 14 days after the date the request for cassation is registered. The Supreme Court must commence adjudicating the request for cassation within 20 days as of the filing of the request for cassation, and give its decision within 60 days after the request for cassation is filed.

Civil Review Process

The Bankruptcy Law covers the process for civil review in Chapter IV (Articles 295 to 298). A request for civil review (peninjauan kembali) against a final and binding court decision can be made only if:

- There is new documentary evidence (novum), which is crucial and that could have reversed the previous court decision if it had been discovered during the court proceedings; or

- The court made a gross mistake in applying the law when rendering its decision. Similar to the request for cassation, the party filing a request for civil review must also submit a memorandum of civil review explaining the reasons for filing the request.

The request for civil review should be filed with the Clerk of the Commercial Court no later than 30 days after the decision to be reviewed is rendered in the event the request is made due to a gross mistake of the court, or 180 days after the date the decision is rendered in the event the request is made due to discovery of new evidence. Within two days after the filing date of the request for civil review, the Clerk of the Commercial Court must deliver a copy of the request and the memorandum of civil review to the other party(ies) to give them a chance to file a response to the request for civil review within 10 days after the date the request was registered. Subsequently, within 12 days after the date the request is registered, the Clerk of the Commercial Court must deliver all documents relating to the request for civil review to the Supreme Court to be adjudicated. The Supreme Court must give its decision on the request for civil review within 30 days after the date the request is registered.

Effects of Bankruptcy Declaration on the Debtor

After the court declares the debtor bankrupt, the debtor loses its capacity to manage and dispose of the bankruptcy estate, and all court enforcement procedures relating to security or other matters are postponed and any attachment order is lifted. The power to undertake any legal action in respect of the bankruptcy estate passes to the curator. The bankruptcy estate consists of all of the bankrupt debtor’s assets at the time of the declaration of bankruptcy (including assets obtained during the bankruptcy but excluding assets stipulated in Article 22 of the Bankruptcy Law).
If a bankrupt debtor is not a natural person but a limited liability company, as a general rule the bankruptcy does not extend to its members (shareholders) because they are "protected" under the limited liability concept: the maximum they can be required to contribute is the remaining unpaid amount of their capital contribution.

Effects of Bankruptcy Declaration on the Creditors

Different Effects for Different Types of Creditors

The creditors affected by the bankruptcy are not all in the same position. Preferred or secured creditors have a priority claim on the proceeds of the sale of any assets that have been pledged as security in their favour, whether a pledge (gadai), fiducia (fidusia), mortgage (hipotek/hak tanggungan) or privilege (hak istimewa). Unsecured/concurrent creditors, on the other hand, share in the division of the remaining assets and obtain satisfaction of their debts in a proportionate percentage. Unsecured/concurrent creditors will share the money proportionately, rather than having a situation where the first creditor to apply will be the first to receive payment. From the date of the declaration of bankruptcy, the unsecured/concurrent creditors can obtain satisfaction of their claims only in the bankruptcy procedure and not through individual enforcement proceedings.

It is important to note that only creditors having a claim against the bankrupt debtor at the time of the bankruptcy declaration may claim payment from the proceeds of the bankruptcy estate. Also note that the payment obligations of the debtor that arise after the bankruptcy declaration cannot be paid from the proceeds of the bankruptcy estate, unless the fulfilment of the payment obligations brings benefits to the bankruptcy estate.

Auctio Pauliana

The Indonesian Bankruptcy Law and Civil Code provide general protection to the interests of creditors. Under those laws, a creditor has the right to request the court to annul any voluntary legal acts of a debtor if the creditor can show that the debtor and its counterparty, when doing those voluntary acts, had knowledge that the action would jeopardise the creditor’s interests. This protection is known as auctio pauliana.

The burden of proof in the action would rest on the debtor if the voluntary act that jeopardises the creditor’s interest was carried out within one year before the date of the bankruptcy declaration. If the act was done earlier than one year before the date of the bankruptcy declaration, the burden of proof in the action would rest on the creditor.

Administration and Liquidation of the Bankruptcy Estate

One of the purposes of bankruptcy is the orderly liquidation of the debtor’s assets and satisfaction of the unsecured/concurrent creditors’ claims on a proportional footing or percentage. The basic principle for the distribution of the proceeds of the bankruptcy estate to the creditors is the equality of the creditors (paritas creditorium), meaning that all creditors have an equal right to payment and the proceeds of the bankruptcy estate must be distributed in proportion to the size of their respective claims.

If the court declares the debtor bankrupt, a curator and a supervisory judge will be appointed.

Supervisory Judge

The supervisory judge is responsible for supervising the actions of the curator with respect to administration and liquidation of the bankrupt estate. Most of the curator’s major decisions are subject to the approval of the supervisory judge. Further, the supervisory judge is
empowered to examine witnesses or order an investigation by experts in order to obtain any information on the bankruptcy proceeding. The court is obliged to hear the advice of the supervisory judge before deciding any matters related to the administration and liquidation of the bankruptcy estate.

Curator

The curator acts as the official receiver of the debtor and administrator and liquidator of the bankruptcy estate in consultation with and under the supervision of the supervisory judge. One of the main duties of the curator is to transform the bankruptcy estate into cash (by selling the bankruptcy estate through public auction or private sale) to be then distributed to the creditors.

The curator may either be a certain person(s) or firm(s), having the required skills and experience, who is an active member of a curators’ association and registered with the Minister of Law and Human Rights, or, in the absence of a specific request for such a firm or person, the Balai Harta Peninggalan ("BHP", the probate court), which is a special agency under the Ministry of Law and Human Rights. The curator is nominated by the party filing the petition for declaration of bankruptcy. If there is no such nomination in the petition, and the petition is granted, BHP will act as the curator. To be appointed, the nominated curator must be independent (i.e. does not have any relationship with either the debtor or any creditor of the debtor) and does not have any conflict of interest.

The court may also appoint an additional curator at any time upon request of the (existing) curator, the supervisory judge or the bankrupt debtor (in the two latter instances, after hearing the opinion of the (existing) curator). The curator’s fees will be based on the guidelines issued by the Minister of Law and Human Rights’ Decree No. M.09-HT.05.10, dated 22 September 1998.

Creditors’ Committee

Besides appointing a curator and a supervisory judge, the court may also appoint a temporary creditors’ committee consisting of three members selected from the creditors that have registered themselves for verification in the bankruptcy declaration or by a later decision if it is deemed necessary or if it is desirable for the interests of the bankruptcy estate; and a permanent creditors’ committee after the verification. The main duty of the creditors’ committee is to provide advice to the curator. The curator, however, is not bound by the committee’s advice or recommendation. In practice, the creditors’ committee is rarely established except in cases where the debtor’s assets are substantial and the creditors are numerous.

Completion of the Bankruptcy

After all acknowledged creditors have received the full amount of their claims or as soon as the final distribution plan (made by the curator) has become binding, the bankruptcy will end. The completion of the bankruptcy must be announced by the curator in the same manner as the announcement of the declaration of bankruptcy (through newspapers). Thirty days after the end of the bankruptcy, the curator will account for its administration and liquidation of the bankruptcy estate to the supervisory judge.

Suspension of Payment Proceedings

Another feature of the Bankruptcy Law is the suspension of payment proceedings. A creditor that foresees its debtor will not be able to continue to pay its debts when they become due and payable, and a debtor that is unable, or predicts that it will be unable to pay its debts
when they become due and payable, may file a petition for suspension of payment of debts with the relevant Commercial Court.

The aim of the suspension of payment is to provide the debtor with more time either to meet its obligations or to come to an agreement with its creditors to restructure the debts. Please note that a suspension of payment can be converted into a bankruptcy if it is clear that the suspension will not be successful, as will be discussed below.

**Commencement of Suspension of Payment Proceeding**

The petition for suspension of payment must be signed by the petitioner and its legal counsel admitted to practice before the court. If the petitioner is the debtor itself, the petition must be accompanied by a schedule comprising the nature of its debts/claims and the creditors to whom these debts are owed (i.e. the creditors’ names, addresses, and the amount of receivables), as well as other relevant documentary evidence. If the petition is filed by the creditor, the court must summon the debtor (through the court bailiff) by registered mail at the latest seven days before the hearing.

Under the Bankruptcy Law, a debtor may also file a petition for suspension of payment after a petition for bankruptcy declaration has been filed against it. If petitions for both suspension of payment and bankruptcy are reviewed by the court at the same time, the petition for suspension of payment prevails and must be decided first. Although it is not a legal remedy as such (i.e. appeal or civil review), a petition for suspension of payment will effectively postpone the bankruptcy process for a certain period of time.

**Composition Plan**

The Bankruptcy Law requires the debtor petitioning for the suspension of payment (the “Applicant”) to submit its settlement or composition plan with its creditors at the time or after the debtor files the petition for suspension of payment. A composition plan with creditors is an agreement made between the Applicant and its creditors for the settlement or arrangement for a discharge of the debts of the Applicant. The composition plan should set out the proposed timetable under which the Applicant will repay its debts and also whether the debts will be fully or partially repaid. The Applicant and all of its creditors are free to agree to the terms of payment they choose. The Bankruptcy Law does not contain any requirements with respect to the contents of the composition plan.

The composition plan will be automatically aborted if, after its submission but before its approval by the creditors, the suspension of payment is terminated (at the end of its intended period or earlier, by the court upon its own initiative, or upon request of either the supervisory judge, the Administrator, or one or more of the creditors, on any of grounds stipulated in Article 255 of the Bankruptcy Law).

The suspension of payment may also be terminated by the court upon request of the Applicant on the grounds that the assets of the Applicant are sufficient to allow it to undertake repayment of its debts again.

**Pre-Submission Workout**

The Bankruptcy Law includes a specific provision on pre-submission workouts, but, in practice, these normally occur in well planned suspension of payment proceedings.
Effectiveness and Effects of the Composition Plan

In order to be valid and effective, a composition plan must be approved in a creditors’ meeting by:

- Affirmative votes of more than half of the concurrent creditors which are present at the meeting, provided that the concurrent creditors voting in favour hold at least two-thirds of all accepted or provisionally accepted unsecured claims held by the concurrent creditors present; and

- Affirmative votes of more than half of the secured creditors which are present at the meeting, provided that the secured creditors voting in favour hold at least two-thirds of all claims held by the secured creditors present.

Please note that votes are only taken from the creditors present in the meeting. The ratified composition plan will bind all of the unsecured creditors. It also binds those unsecured creditors who voted against the acceptance of the composition plan and those unsecured creditors who were not present or represented at the voting hearing.

Effects of Suspension of Payment

One effect of a suspension of payment is that the debtor cannot be forced to pay its debts within the suspension of payment period. Unlike in bankruptcy, a debtor in suspension of payment may still manage or dispose of its assets and even obtain loans and secure its unsecured assets, provided that those acts have been authorised by the administrator and/or the supervisory judge.

Termination of Suspension of Payment

A suspension of payment may be terminated by the Commercial Court on a request submitted by the administrator, the supervisory judge or any of the creditors, or on the Commercial Court’s own initiative, if:

- The Applicant, in bad faith, takes action during the suspension of payments which is detrimental to its assets or the interests of its creditors;

- During the suspension of payment, the Applicant performs actions of management or transfers rights to any part of its assets, without authorisation from the Administrator;

- The Applicant neglects to do what the court ordered at the time or after the suspension of payment was granted, or neglects to do what the Administrator requires in the interests of the debtor’s assets;

- The Applicant’s assets are in such a state that a suspension of payments would no longer be feasible; or

- The Applicant is in such a condition that it cannot be expected to fulfil its obligations towards the creditors on time.
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Overview and Introduction

Insolvency proceedings typically aim to liquidate an insolvent entrepreneur’s assets with full discharge vis-à-vis all creditors.

Traditional Italian insolvency proceedings are extremely formal and require the involvement of courts and/or other public authorities, regardless of the size of the bankruptcy estate; consequently, they are usually lengthy and costly, the average duration being seven years.

In recent years alternative in-court and out-of-court arrangements have been introduced, which aim to facilitate the discharge of insolvent companies through compositions with creditors.

Currently, under Italian law, the insolvency procedures ("procedure concorsuali") for rehabilitation or liquidation of a company include:

- Bankruptcy ("fallimento");
- Pre-bankruptcy composition ("concordato preventivo");
- In-bankruptcy composition ("concordato fallimentare");
- Debt restructuring arrangements and certified turnaround plans ("accordi di ristrutturazione dei debiti e 'piani attestati di risanamento");
- Extraordinary administration of large enterprises in a state of crisis ("amministrazione straordinaria delle grandi imprese in stato di crisi"); and
- Forced administrative liquidation ("liquidazione coatta amministrativa").

Bankruptcy is the primary procedure and aims to assess the debtor’s liabilities, sell its assets and distribute the proceeds among the creditors. During the proceedings, the debtor is deprived of the authority to manage and dispose of its assets, and these powers are delegated to a bankruptcy administrator under the direction and supervision of the delegated judge. Where the debtor is a company, upon completion of the bankruptcy procedure it will cease to exist. If the debtor is a sole proprietorship, he will cease to be an entrepreneur (and will generally be prohibited from starting a new business for a number of years). In general, bankruptcy can be defined as a liquidation (and not a work-out) procedure.

Work-out procedures, such as pre-bankruptcy composition, debt restructuring arrangements, turnaround plans and even extraordinary administration, are aimed at enabling a debtor in financial difficulty to restructure its operations (and particularly its debt) itself in order to continue its activities and pay back its creditors. Unlike bankruptcy, the aim is not the liquidation of the company, but its survival. It is worth noting, however, that the extraordinary administration and pre-bankruptcy composition may develop into bankruptcy if the recovery proves impossible (and in other cases), provided that the relevant conditions are met.

Voluntary liquidation is a corporate unwinding process governed by compulsory provisions of law and aimed at satisfying the company’s creditors by liquidating the company’s assets and paying any remaining assets or proceeds over to the shareholders. Therefore, during this process, the company still exists and operates (though no new business can be carried out) and can also be declared bankrupt; the management body is replaced by one or more...
liquidators which are vested with limited management powers aimed at carrying out and completing the liquidation process.

Applicable Legislation

The statutory framework for insolvency-related procedures is primarily set out in Royal Decree no. 267 of 16 March 1942 (the “Italian Bankruptcy Law”). The Italian Bankruptcy Law has undergone extensive revisions in the last decade, which have shifted the focus from the protection of creditors through the liquidation of assets and distribution of proceeds to a wider range of opportunities for discharging debts via composition. The clawback regime previously in place has also been relaxed. Further important changes that have been introduced in recent years include:

- Increasing the number of entities excluded from bankruptcy proceedings;
- Changing and widening the powers of the bankruptcy receiver; and
- Increasing the powers of the creditors’ committee.

In addition, the position of the debtor has been improved, through:

- The abolition of the public register of bankrupt debtors; and
- The introduction of a debt discharge process for individual entrepreneurs.¹

Material innovations regarding the pre-bankruptcy composition and debt restructuring arrangements under Article 182-bis of the Italian Bankruptcy Law and turnaround plans under Article 67, paragraph 3(d), of the Italian Bankruptcy Law have been introduced by Law Decree no. 83 of 22 June 2012, as converted by Law no. 134 of 3 August 2012 (the “Development Decree”). The purpose of this reform was to boost the restructuring and reorganisation of distressed enterprises in order to better cope with the current financial crisis. To achieve this purpose, the Development Decree has focused mainly on three factors: flexibility of the process, reliability of the restructuring plan and tax appeal.

Amendments to the Italian Bankruptcy Law have also been introduced with regard to the Pre-Bankruptcy Composition by Decree no. 69 of 21 June 2013, which sets out urgent measures aimed at boosting the country’s economy (the “Decreto del Fare”) and includes some important changes to the rules regarding the application introduced by the Development Decree.

Further amendments to the Italian Bankruptcy Law have been enacted by Law Decree no. 83 of 27 June 2015 (“Urgent reforms concerning Bankruptcy Law, Civil Law, Civil Procedure Law and Court administration”), as converted by Law no. 132 of 6 August 2015. They mainly regard the Pre-Bankruptcy Composition and Debt restructuring arrangements and aim at facilitating debt restructuring of the distressed enterprises.

¹ A debtor who is an individual can obtain discharge of some debts in the case of good conduct if he has:
- Cooperated with the administrative bodies in the proceedings;
- Not caused delay in the proceedings;
- Complied with the order to provide the bankruptcy receiver with the correspondence concerning the relationships involved in the bankruptcy;
- Benefited from the same procedure in the last 10 years;
- Not committed criminal offences such as the misappropriation of assets or the reporting of non-existent liabilities; causing or worsening the insolvency in order to make difficult the reconstruction of the assets and business; unlawfully obtaining financing;
- Not been convicted of fraudulent bankruptcy or offences against the economy, industry or commerce (unless rehabilitated).
Finally, a new electronic insolvency register has been established in the Ministry of Justice by Law Decree no. 59 of 3 May 2016 (which still awaits ratification by the Parliament). The aim of this register is to publish all the information and documents regarding bankruptcy procedures, pre-bankruptcy composition procedures, forced administrative liquidation procedures, extraordinary administration procedures and procedures for the approval of debt restructuring arrangements.

The Italian Council of Ministers has recently approved a delegated law bill (prepared by the “Rordorf Committee”) which aims to thoroughly reform the Italian Bankruptcy Law. It would introduce an effective alert mechanism at the first signs of bankruptcy, limit access to the pre-bankruptcy composition to companies capable of being revived and specifically regulate corporate groups. Furthermore a specialised judge is contemplated for minor bankruptcy cases.

All references in this chapter are to the law as applicable to new insolvencies. Old procedures may, however, still be governed by old rules.

Personal Bankruptcy

With the exception of state entities and small undertakings, the Italian Bankruptcy Law applies to all entrepreneurs and only to them. As a result, non-entrepreneur individuals cannot be declared bankrupt.

Winding-Up Procedures: Liquidation – Voluntary and Involuntary

Although liquidation is a winding-up procedure for partnerships and companies, it does not imply a situation of insolvency; in fact, liquidation can only be successfully completed if the company is not insolvent.

Voluntary liquidation is commenced by resolution of the shareholders, who appoint one or more liquidators. The liquidators replace the management body and are required to:

• Manage the company’s assets and perform any acts required by the winding-up process;
• Draw up the company’s annual and final liquidation balance sheets and relevant reports; and
• Pay off creditors.

Unless the shareholders challenge the balance sheet presented by the liquidators within 90 days, it becomes final and the liquidator can distribute the proceeds to the shareholders. Ultimately, the company is cancelled from the companies’ register.

Involuntary liquidation occurs: (i) when the term of existence of the company expires; (ii) upon achievement of the corporate purpose, or when achievement becomes impossible; (iii) if shareholders’ decisions cannot be taken because of deadlock; (iv) when the company’s capital is reduced below the statutory minimum and not increased back; (v) in case of redemption of all shares; and (vi) for any other reasons set out in the by-laws.

Bankruptcy

The key insolvency procedure is bankruptcy (“fallimento”). Bankruptcy is a court-supervised procedure for the liquidation of an insolvent company’s assets and distribution of the proceeds. It results in the company’s dissolution.
Eligibility for Bankruptcy

As noted above, bankruptcy applies to business undertakings, with the exception of state entities and small businesses.

Small businesses are those which:

- Have had, in each of the three fiscal years before the date of filing of the petition for bankruptcy or, if less, from the beginning of the business’s activity, net equity not exceeding EUR 300,000;
- Have realised, in each of the three fiscal years before the date of the filing of the petition for bankruptcy or from the beginning of the activity (if less), gross revenues not exceeding EUR 200,000;
- Owe debts, even if not yet due upon adjudication, not exceeding EUR 500,000.

The limits provided for under the above-mentioned letters can be updated every three years by means of a decree of the Minister of Justice, on the basis of the average of the variations in the ISTAT (“Istituto Nazionale di Statistica”) index of the consumption prices for families and blue- and white-collar workers for the period of reference.

The pre-requisite for a declaration of bankruptcy is a non-reversible state of insolvency. This exists where:

- The company is in default on its payment obligations; or
- Other evident indicia exist that the company is unable to meet its current liabilities on a regular basis.

According to certain court precedents, “indicia of insolvency” can be found even prior to, and regardless of, payment defaults, if it is foreseeable that the debtor will no longer be in a position to regularly pay its debts. Insolvency may also be found to exist upon even only one event of default, if the event demonstrates that the debtor is in distress. Even non-payment of a negligible debt, if related to essential services (such as public utilities) and if accompanied by scarce liquidity and an imbalance between assets and liabilities, can be considered a symptom of insolvency. Article 7 of the Italian Bankruptcy Law also provides that insolvency may be considered proved where the debtor flees or escapes arrest or shuts down his business premises. In such cases, the public prosecutor dealing with any such crimes must file a request with the competent Bankruptcy Court to declare the debtor’s bankruptcy.

Finally, pursuant to Article 15 of the Italian Bankruptcy Law, bankruptcy cannot be declared if the company’s overdue debt amounts to less than EUR 30,000.

Bankruptcy Petition

Pursuant to Article 6 of the Italian Bankruptcy Law, bankruptcy proceedings are commenced by a petition filed by any of the creditors of the “insolvent” debtor, the public prosecutor or the insolvent debtor itself.

The insolvent debtor is under no obligation to file for bankruptcy, but Article 217 of the Italian Bankruptcy Law states that a debtor (including the debtor's legal representative) who delays the filing of a petition for bankruptcy commits the crime of simple bankruptcy (“bancarotta semplice”), where such delay has worsened the debtor’s distress; this may also be true where the filing of the petition has been put off because of the implementation of an out-of-
court voluntary composition plan, in case bankruptcy should follow. It must also be noted that the liability may be imposed upon advisors who have assisted the debtor company.

Under the same provision, any delay by the directors of a debtor to request to the debtor’s admission to bankruptcy may also be construed as mismanagement (“mala gestio”), i.e. violation by the directors of their duties. They would therefore be liable for damages suffered by the company’s creditors and shareholders.

Additionally, pursuant to the same Article 217, delaying the admission of the debtor to bankruptcy protection can be relevant in terms of criminal liability if the debtor undertakes “seriously incautious transactions” with the purpose of delaying the declaration of bankruptcy. “Seriously incautious transactions” include transactions that are not per se imprudent or hazardous, but which acquire such character if effected when the company is in state of insolvency. Examples include: the lease of the business to a third party in financial distress, at a low rent and without security; the sale of inventory at a lower-than-market-price; and the disposal of material assets.

Such crimes are punished with imprisonment of between six months to two years. The persons who can be punished for these crimes are: the entrepreneur who conducts the individual business; the directors of the debtor with management and representative powers; the debtor’s general manager; and the debtor’s liquidator and statutory auditors (plus aiders and abettors, including advisors).

Persons Entitled to File for Bankruptcy

Management Body

Where the debtor is a company, no previous shareholders’ resolution is required. The management body takes the decision to file for bankruptcy and can give a proxy to one of the directors or a third party to effect the actual filing.

Third Parties

A petition can also be filed by the company’s creditors, provided that the debts of the company which become overdue during the pre-bankruptcy evidential phase of the procedure amount to no less than EUR 30,000.

Public Prosecutor

The public prosecutor can file a petition for bankruptcy in two specific cases:

- When the state of insolvency arises in the course of criminal proceedings, or when the debtor has fled or cannot be traced, or when he has shut down the premises or disposed of, replaced or fraudulently diminished the business assets; and
- When the insolvency is brought to the attention of the public prosecutor by a judge who has ascertained such insolvency during the course of civil proceedings.

The option for the competent court to declare the bankruptcy of the debtor ex officio has recently been abrogated.

Formalities of Filing for Bankruptcy

The petition for bankruptcy must be filed with the Bankruptcy Court of the district where the debtor has its “main place of business” in Italy.
Article 14 of the Italian Bankruptcy Law provides a list of items to be included in or attached to the debtor’s petition:

- The mandatory accounting and fiscal books (including, therefore, the balance sheet of the company) concerning the three fiscal years prior to the filing of the relevant petition or the entire existence of the company, if this is of a shorter duration;
- A description and evaluation of its assets;
- A list of the creditors and their relevant claims;
- An indication of the gross revenues for each of the last three fiscal years;
- A list of secured creditors, an indication of the relevant assets and the title upon which the relevant security interest is based.

**Adjudication in Bankruptcy; Appointment of a Receiver and Creditors’ committee**

**Bankruptcy Judgment**

The Bankruptcy Court will verify whether the petition for bankruptcy is formally valid and whether the conditions for bankruptcy are met. If both are confirmed, the Bankruptcy Court will declare the company bankrupt. The bankruptcy judgment has immediate effect starting from the day of its docketing.

The bankruptcy judgment can be appealed by the debtor as well as by any interested party (except the applicant who can, nonetheless, appeal rejection of a petition within 30 days after service of the notice of rejection). The Court of Appeal has jurisdiction to decide the appeal. An appeal does not suspend the effects of the adjudication, but the Court of Appeal may, upon request of the appellant or of the bankruptcy receiver, suspend totally, partially or temporarily the liquidation of the assets where serious reasons subsist.

The delegated judge is appointed by the Bankruptcy Court at the time of adjudication.

**The Bankruptcy Receiver**

In the adjudication judgment the Bankruptcy Court also appoints a bankruptcy receiver ("curatore"), an accountant or lawyer experienced in insolvency matters and enrolled on a special register maintained by the Bankruptcy Court.

The bankruptcy receiver acts as a public officer and is required to perform his duties in person. However, if necessary, he may be allowed by the delegated judge ("giudice delegato") to obtain expert or professional assistance. The bankruptcy receiver is paid out of the debtor’s assets and his remuneration takes precedence over creditors’ claims ("prededuzione"). The bankruptcy receiver acts in conjunction with a creditors’ committee ("comitato dei creditori"), consisting of three to five creditors appointed by the delegated judge, which has an advisory as well as a supervisory role in the bankruptcy procedure.

Prior to recent changes the only restriction regarding the appointment of the bankruptcy receiver was that a person having a conflict of interest with the bankrupted company or the bankruptcy procedure could not be appointed; now it is expressly provided that a bankruptcy receiver must be a lawyer, an accountant, a person who has acted as financial officer or controller, or a law or accountancy firm. A receiver can be replaced by vote of a majority (in terms of value of claims) of the creditors.
The bankruptcy receiver’s duties are to:

- Locate and dispose of the debtor’s assets;
- Review the creditors’ claims, both secured and unsecured;
- Prepare a list of the debtor’s liabilities and submit it to the court;
- Report to the creditors’ meeting on the status of the debtor’s assets and liabilities; and
- Use the funds available to pay off creditors’ claims pari passu, subject to priorities certified by the Bankruptcy Court.

The bankruptcy receiver’s actions are subject to review of the delegated judge at the petition of the debtor or any other interested party.

The bankruptcy receiver fixes his seal on the assets of the bankrupt entity shortly after his appointment. Formerly, the liquidation of the assets was made on a piecemeal basis to be authorised. Current law requires the bankruptcy receiver to prepare a liquidation plan within 60 days from the fixing of his seal and in any case not later than 180 days from the bankruptcy judgment (104-ter of the Italian Bankruptcy Law) for the approval of creditors’ committee members.

The aforesaid plan must indicate the deadline to complete the liquidation of the assets, which cannot anyway go beyond two years from the filing of the judgment declaring bankruptcy, unless the receiver deems it necessary to ask for a longer term and therefore specifically justifies this request. Should the deadlines indicated in the liquidation plan not be met without reasonable grounds, the receiver’s appointment shall be annulled. The delegated judge receives a communication relevant to the approved plan and authorises the execution of the acts as provided by the plan itself. The plan can mention the existence of an in-bankruptcy composition (described below) with creditors.

In order to distribute proceeds, the bankruptcy receiver shall present, every four months following the date of the decree issuing the statement of liabilities and based on the liquidation plan, a schedule of the amounts available and a draft breakdown of those amounts by which creditors are then paid off. In case of failure to meet such obligations, the receiver is revoked.

**Creditors and the Creditors’ committee**

Creditors (and alleged owners of property existing on the debtor’s premises that the bankruptcy receiver rules to be the debtor’s property) must file a proof of claim with the bankruptcy receiver. Any disputes regarding these claims are settled by the Bankruptcy Court.

The Creditors’ committee is composed of representatives of the creditors. These representatives must reflect the type (preferred, secured and unsecured) and size of the claims. The creditors’ committee is appointed by the delegated judge handling the liquidation within 30 days from the judgment declaring bankruptcy, following consultation with the bankruptcy receiver and creditors. A majority (in terms of value of the claims) of the creditors may appoint new members at the hearing for the admission of the claims. The recent Law Decree no. 59 of 3 May 2016 considers a Creditor’s committee to be established in the moment of acceptance, including by electronic means, of the appointment by the nominees.

The involvement of the creditors in the administration of the bankruptcy estate is limited.
Consequences of Bankruptcy

Effects on the Debtor

From the time of the adjudication, the debtor is dispossessed. The bankruptcy receiver manages and disposes of the assets under the direction of the delegated judge. The debtor may no longer validly act in court as plaintiff or defendant in relation to the assets (Article 43 of the Italian Bankruptcy Law). The bankruptcy receiver is vested with such powers upon the authorisation of the delegated judge. However, all pending proceedings in which the debtor is involved are automatically stayed from the date the adjudication is issued and need to be re-initiated by or against the bankruptcy receiver.

In order to speed up the legal disputes involving a bankrupt entity, the Conversion Law no. 132/15 provides that all these disputes shall be handled with priority over all other proceedings.

Effect on Creditors

From the date of the adjudication, no attachment, garnishment or other enforcement action may be initiated or continued against assets of the bankrupt estate (Article 51 of the Italian Bankruptcy Law). Where such actions have been commenced prior to adjudication, they will be automatically stayed and absorbed in the bankruptcy procedure.

Creditors are required to submit their proofs of claim at least 30 days before the hearing for the verification of the claims. The bankruptcy receiver should prepare and send a preliminary list of liabilities to the creditors 15 days before the hearing. Creditors must provide comments no later than five days before the hearing. At the hearing, which can be held also in absence of creditors or by electronic means (as stated by recent Law Decree no. 59 of 3 May 2016), the delegated judge either admits or rejects the claims. Once a review of all claims is completed, the delegated judge issues a statement of liabilities by decree. Creditors may challenge the decree both in connection with their own and other creditors’ claims.

If proofs of claim are submitted later than 30 days before the hearing, they are considered “late claims” (“domande tardive”); however, no late claims are entertained that are submitted later than one year after the judge’s decree issuing the statement of liabilities (or 18 months if the procedure is particularly complex). Late admitted creditors share only in distributions made after the time of admission (Article 101 of the Italian Bankruptcy Law).

Effect on Operations

By default, adjudication involves the cessation of all the activities of the company with a view to a sale of all assets. However, the Bankruptcy Court may order that business operations be continued whenever cessation could cause “serious harm”, provided that the continuation does not adversely affect the creditors of the bankrupt debtor. If the Bankruptcy Court authorises the continued operation of the business, the management of the business is entrusted to the bankruptcy receiver (who may in turn avail himself of qualified third parties for this purpose).

As an alternative to the continued operation of the business by the bankruptcy receiver, the delegated judge may, with the consent of the representatives of the creditors, authorise the lease of the business as a going concern to a third party. This can be authorised whenever useful for the purpose of eventually selling the business under more favourable terms (this would be the case, for example, whenever the interruption of operations would significantly damage the debtor’s goodwill, thus causing a loss of value).

Finally, the business of the bankrupt company could be sold to a third party en bloc as a going concern, rather than through a sale of the individual assets that comprise it. The sale
of the business *en bloc* is the preferred solution under the Italian Bankruptcy Law, for two reasons: firstly, it is assumed that the sale of an ongoing business may realise a higher price than the sale of the individual assets comprising the business; secondly, it is a more efficient way of liquidating the assets. It should be noted that if the business was previously leased to a third party by the bankruptcy receiver, the third party has a right of first refusal in case of sale *en bloc* of the business.

**Effect on Contracts**

Articles 72 to 83 of the Italian Bankruptcy Law govern the effects of the bankruptcy on contracts to which the debtor is a party. The rules vary depending on the nature of the contract, but, generally, a bankruptcy affects contracts in three different ways:

- By causing the automatic termination of the contract, in all cases where performance by the bankruptcy receiver would be impossible due to the immediate cessation of the debtor’s activities;
- By granting the bankruptcy receiver a right of election between termination of the contract and its continuation; and
- If the receiver elects to continue the contract, by providing for the automatic replacement of the debtor with the bankruptcy receiver in such contracts.

The second option above is deemed to be the default rule. In such cases, if the bankruptcy receiver does not respond in a timely manner, the other party can request the Bankruptcy Court to set a deadline not exceeding 60 days for the bankruptcy receiver to notify his decision. If the bankruptcy receiver does not reply within the deadline set by the Bankruptcy Court, the contract is deemed to be terminated.

It is worth noting that contractual clauses providing for termination in case of bankruptcy of either party are ineffective *vis-à-vis* creditors (Article 72, paragraph 6 of the Italian Bankruptcy Law). While there are not yet any precedents, the prevailing view still seems to be that such a rule only applies from adjudication, so that the parties would remain free to provide for termination at an earlier stage of financial distress. Certain scholars, however, challenge this interpretation in that it would allow the parties to circumvent Article 72, paragraph 6.

**Set-Off**

Pursuant to Article 56 of the Italian Bankruptcy Law, “*the creditors can offset their claims against their debts to the debtor, even if such claims are not yet due upon adjudication; however, claims that are not yet due at adjudication cannot be offset if the creditors purchased them in the year before adjudication or after adjudication*”.

While this provision primarily addresses automatic set-off (which requires that the claims be due, quantified and certain), according to some case law precedents the judicial set-off (which is not subject to the above limits and must be declared by a court) is considered admissible in bankruptcy.

A first limit to set-off is that both claims must exist at the time of adjudication. Therefore no set-off can exist between a claim against the bankrupt company and a clawback claim of the bankruptcy receiver, as the latter arises after adjudication.

A second limit to set-off in bankruptcy concerns claims that were not yet due at adjudication and that are purchased by a bankrupt’s debtor after adjudication (or in the previous year).
Finally, it is worth noting that contractual set-off effected prior to bankruptcy is recognised; however, if executed during the relevant suspect period, it can be subject to clawback as a preferential discharge. While the prevailing opinion is that the longer (one-year) suspect period applies, certain scholars challenge this position and submit that contractual set-off should be viewed as an ordinary disposition against consideration and therefore subject to a six-month suspect period. Besides the difference in length of time, in the latter case the burden would be on the bankruptcy receiver to prove that the defendant was aware of the state of insolvency of the bankrupt debtor at the time the set-off was effected, and not on the defendant to prove that he was not aware, as in the former case.

Clawback Actions

Rationale

A fundamental principle of the Italian Bankruptcy Law is the equal treatment of all creditors ("par condicio creditorum"), according to which, absent statutory priorities, no creditor may be paid a higher percentage of his claim than other creditors. A consequence of this principle is not only that the payment of debts by the bankruptcy receiver is strictly regulated, but also that all transactions effected by the debtor over the previous year (or, in certain cases, over the previous six months) are scrutinised and possibly unwound as preferential.

The preferential nature of a transaction effected in the six months/one year prior to bankruptcy is always de facto assumed. Even arm's length transactions (e.g. ordinary sales, payment of debts, etc.) are usually considered to be preferential, and the only way to prevent avoidance is to prove that the estate would not obtain any benefit from voiding such transactions. Unfortunately, the unwinding is almost always beneficial to the estate, as the other party is left with an unsecured claim against the estate, which is automatically less valuable than what is returned.

In order to void preferential transactions effected over the previous six months, the bankruptcy receiver also needs to prove that the other party was aware that the debtor was insolvent. However, such knowledge is assumed in certain instances, such as following the insertion of the debtor’s name in the bulletin of unpaid negotiable instruments (e.g. notes, drafts, checks) or in case of foreclosures or collection procedures against the debtor. It goes without saying that if the creditor sued in a clawback action is able to prove that the debtor was not insolvent at the time of the claimed payments, this will represent a valid defence.

Elements of Clawback Actions

Any transaction or payment which has the effect of putting a creditor into a better position than it would otherwise have been vis-à-vis other creditors constitutes a violation of the par condicio principle (equal treatment of all creditors) and therefore potentially subject to clawback. Recent changes have shortened the suspect period, defined the meaning of a “transaction not a fair value” (a transaction in which the disproportion of the consideration to the detriment on the insolvent debtor is greater than 25%) and provided for some exemptions (as described below).

- Transactions. Article 67 of the Italian Bankruptcy Law, first paragraph, provides that:

  "Unless the other party proves that it was not aware of the state of insolvency of the debtor, the following shall be set aside:

  1. transactions for consideration occurring within the one year prior to the date of declaration of bankruptcy, where the services performed or the obligations undertaken by the bankrupt exceed of at least 25% of what has been given or promised to him;"
2. the extinguishing of financial debts which have fallen due and are outstanding, not effected in cash or through other normal forms of payment, if made within the one year prior to the declaration of bankruptcy;

3. pledges, antichresis rights and voluntary mortgages granted or set up within one year prior to the declaration of bankruptcy for pre-existing debts which had not yet fallen due;

4. pledges, antichresis rights and judicial or voluntary mortgages created within six months prior to the declaration of bankruptcy as collateral for debts which had fallen due.

• Payments. Article 67 of the Italian Bankruptcy Law, second paragraph, provides that:

  o “If the bankruptcy receiver proves that the other party was aware of the state of insolvency of the debtor, the payment of due and outstanding debts, transactions for consideration and those granting a preferential right for debts simultaneously created shall also be set aside if made within six months prior to the declaration of bankruptcy […]”

  o It is also important to note that: “Deeds executed by the debtor on a gratuitous basis [i.e., without any valuable consideration] within the two years prior to the date of declaration of bankruptcy shall be without any effects vis-à-vis all creditors” (Article 64 of the Italian Bankruptcy Law). In such cases the repossession of the assets by the bankruptcy receiver is automatic. In other words, it is not necessary to prove that the other party was aware of the state of insolvency of the debtor.

  o It is finally worth noting that under Article 65 of the Italian Bankruptcy Law, payments of debts not yet due at the time of adjudication in bankruptcy which are made by the debtor in the two years preceding bankruptcy are not considered valid and must be returned to the bankruptcy estate.

• Exemptions from clawback action. Article 67(3) of the Italian Bankruptcy Law provides, inter alia, that:

  “The following are not subject to clawback actions:

1. The payments of assets and services effected in the interest of the entrepreneurial activities in accordance with commercial terms and practices; […]

2. Transactions, payments and security granted on the debtor’s assets provided that they have been made in furtherance of a restructuring plan under the terms and conditions provided for by Article 2501-bis, fourth paragraph of the Italian Civil Code […]. The reference means that an expert must certify that the plan is reasonably capable, if implemented, of resolving the financial distress and furthermore (in accordance with the new provisions introduced by the Development Decree) must assess the truthfulness of the accounting data and the feasibility of the plan itself, in line with the provisions governing the pre-bankruptcy composition plan;”

2 The Development Decree has modified article 67 paragraph 3(d), clarifying that the expert is chosen by the debtor and must meet the following independence requirements: (i) he cannot be linked to the debtor through private or professional relationships which may jeopardise his independence; (ii) he has to meet the requirements set forth in article 2399 of the
3. **Transactions, payments and guarantees made in execution of a pre-bankruptcy composition plan or debt restructuring arrangement approved pursuant to Article 182-bis and furthermore transactions, payments and guarantees made after the filing of the petition pursuant to Article 161 [of the Italian Bankruptcy Law (i.e. those effected after the filing of the request for admission to the pre-bankruptcy composition plan in accordance with the relevant provisions)];**

4. **Payments made when due in order to obtain the performance of services aimed at allowing the debtor to access other minor insolvency procedures.”**

If the bankruptcy receiver is satisfied that a violation of the *par condicio creditorum* rule has occurred, it would certainly initiate a clawback action against the creditor in order to recover the lost value by means of an ordinary writ of summons before the Bankruptcy Court. Ordinary proceedings are thereby initiated.

The statute of limitations for initiating clawback action proceedings is three years from the declaration of bankruptcy or, if earlier, five years from the act or transaction to be clawed back.

It is to be noted that special statutes have introduced clawback exemptions or departures from the general rules. As an example, payments from account debtors of securitised receivables cannot be clawed back under Section 67 of the Italian Bankruptcy Law, while the sale of the receivables itself is subject to clawback by the seller's trustee but the relevant terms are halved (three and six months). The decree “Destination Italy” (Decreto “Destinazione Italia” no. 145 of 23 December 2013, confirmed by the Parliament in February 2014) has further exempted payments from account debtors of securitised receivables from the special clawback under Section 65 of the Italian Bankruptcy Law. Similarly, payments from account debtors of factored receivables under Law no. 51 of 1992 (factoring law) are exempt from clawback; however the assignor can be forced to repay the relevant amounts if he was aware of the state of insolvency at the time of the payment of the price of the assignment, and the assignee could be liable to the assignor if the sale was without recourse.

**Criminal Provisions**

As mentioned above, when bankruptcy is declared, criminal liabilities may be imposed.

The Italian Bankruptcy Law provides for a certain numbers of bankruptcy crimes. They are divided into two main groups: crimes committed by the insolvent debtor (including unlimited liability shareholders); and crimes committed by persons other than the bankruptcy entrepreneur (i.e. directors, general managers, liquidators and statutory auditors, creditors and the bankruptcy receiver).

In particular, an insolvent debtor can be punished for, inter alia, distracting, concealing or destroying assets of the estate or for showing non-existent liabilities in order to prejudice creditors’ rights (Article 216 of the Italian Bankruptcy Law) (“bancarotta fraudolenta”). The same provision punishes debtors who manipulate mandatory accounting or corporate records to their own benefit (“bancarotta fraudolenta documentale”) or who, prior to or during the bankruptcy procedure, paid debts in order to give preference to a certain creditor to the detriment of the other creditors (“bancarotta fraudolenta preferenziale”).

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*Italian Civil Code for internal auditors (sindaci) of a joint stock company; and (iii) he must not have been employed by the company in distress or have taken part in its management and supervisory bodies within the last five years.*
Article 217 of the Italian Bankruptcy Law contemplates less serious bankruptcy crimes committed by the insolvent debtor, e.g. the crime mentioned in “Bankruptcy Petition” above, in relation to delays in filing a petition for bankruptcy or the non-fulfilment of obligations undertaken in connection with a request for pre-bankruptcy composition or in-bankruptcy composition.

Other bankruptcy crimes for which the insolvent debtor can be punished include the abusive obtaining of credit (Article 218 of the Italian Bankruptcy Law) and the indication of non-existing creditors (Article 220 of the Italian Bankruptcy Law).

The second group of bankruptcy crimes includes those which can be committed by persons other than the insolvent debtor.

Pursuant to Articles 223–226 of the Italian Bankruptcy Law, criminal liability and similar sanctions for the bankruptcy crimes indicated above are extended to directors, general managers, liquidators and statutory auditors (if appointed) of a bankrupt company. This group of crimes further includes certain crimes that can be committed by persons who are not part of the company’s charter. Creditors can be punished for trading votes in connection with the debtor’s request for pre-bankruptcy composition or in-bankruptcy composition (Article 223 of the Italian Bankruptcy Law). Under Articles 228–230 of the Italian Bankruptcy Law, the bankruptcy receiver can be punished for specific criminal offences such as having a private interest in the bankruptcy procedure.

Of the specific criminal offences in the aforementioned provisions, third parties (“extranei”) may only be criminally liable in respect to bankruptcy crimes for complicity with those who committed the crime (“intranei”) under the general provisions of the Italian Criminal Code.

Priority of Claims

Rights of Creditors during a Judicial or Regulatory Insolvency Resolution Process

As noted above, the fundamental principle of Italian Bankruptcy Law is the par condicio creditorum, which means that all creditors have an equal right to payment pro-rated to their claims. However, there are two groups of creditors that enjoy preferential treatment (“creditori privilegiati”); creditors who hold a security interest (“creditori ipotecari o pignoratizi”); and creditors who have a preference under law (“creditori privilegiati in senso stretto”). Therefore, the equality principle only applies to those creditors who have an unsecured and non-preferred claim (“creditori chirografari”). They share pro rata after satisfaction of secured and preferred creditors.

Pledges and preferred creditors holding a lien over movable assets also have a “right of retention” (“diritto di ritenzione”). This right allows those creditors (but only after their priorities have been finally ascertained) to seek authorisation to sell the relevant assets outside the procedure, but in accordance with rules set forth by the judge. Also, in these cases, the bankruptcy receiver may seek authorisation from the delegate judge to redeem such assets.

Secured Creditors

As a general principle, creditors holding a security interest are satisfied from the relevant assets to the exclusion of all other creditors, including secured creditors having a lower rank (e.g. first mortgage over second mortgage). However, the Italian Civil Code contains very detailed rules (Articles 2745) regulating priority conflicts between secured and preferred creditors.
The main categories of secured creditors are:

- Creditors who hold a mortgage on real property;
- Creditors who hold a pledge on movable assets (including claims of the debtor against third parties); and
- Creditors who hold a contractual lien on an entrepreneur's assets under section 45 of the Italian Banking Law.

A mortgagee and a pledgee are entitled to satisfy their claims from the proceeds of the sale of the encumbered assets. Any excess is available for distribution to other creditors (i.e. second mortgagees, preferred creditors and unsecured creditors). Where the relevant asset is insufficient to satisfy its claim against the debtor, a creditor will rank as an unsecured creditor for the remainder. Third parties claiming title to assets included in the estate (including on the basis of title retention clauses) are technically not considered secured creditors, because they are entitled to restitution and not to the proceeds of the sale of their assets.

**Preferred Creditors**

A preferred creditor is a creditor whose claim is given statutory priority (by a statutory lien) over other creditors. No priority may be created contractually. Such liens may apply to all of the debtor’s property or to specific property only.

**Post-Adjudication Creditors**

Certain claims are regarded as “claims against the administration of the estate” (“creditori della procedura, prededuzione”). In general, claims that arise as a result of, or following, adjudication in bankruptcy, are considered claims against the estate administration and have priority over secured and unsecured claims. Examples of these claims are:

- All the bankruptcy receiver’s fees and costs;
- The costs of the sale of the assets;
- The rent for the debtor’s offices after adjudication;
- Employees’ salaries and social security payments relating to the period after adjudication; and
- Attorney’s and other advisors’ fees.

**Unsecured Creditors**

Unsecured creditors have no preference or security and will therefore be paid only if and to the extent any proceeds of the estate remain after all other claims have been satisfied. Unsecured creditors rank *pari passu* among themselves in the estate, in proportion to the size of their claims.
Order of Distribution

The order of distribution of proceeds from the sale of assets that are not reserved for creditors holding security interests or specific statutory liens is as follows:

- Post-adjudication claims, i.e. claims created after the adjudication, which have precedence over all other claims ("crediti prededucibili") (such as costs and permitted indebtedness incurred during the bankruptcy procedure), including secured claims;
- Taxes on real property (limited to the real property being sold);
- Employees’ entitlements, including, without limitation, termination benefits;
- Claims of independent professional contractors who performed services for the bankrupt company during the 12-month period prior to bankruptcy; commissions due within the previous 12 months pursuant to agency agreements; and compensation for the termination of agency;
- Farmers’ claims;
- Claims of suppliers of production plants and equipment, and the claims of banks which financed the purchase thereof;
- Income taxes;
- Local taxes, social security payments and insurance premiums;
- Other unsecured creditors’ claims;
- Subordinated claims; and
- Equity holders’ right of distribution of any excess.

Secured claims rank always ahead of claims in the last three categories and sometimes ahead of other claims, depending on the type of security.

Exit

If there are insufficient assets in the estate to cover the costs of the bankruptcy procedure (i.e. bankruptcy receiver’s fees), the bankruptcy receiver will notify the Bankruptcy Court and the Bankruptcy Court will summarily liquidate the company, terminating the bankruptcy.

Once all the assets have been liquidated and the relevant payments made to creditors, upon request of the bankruptcy receiver or of the debtor, the Bankruptcy Court declares the bankruptcy closed and the company ceases to exist. Termination of liquidation is mentioned in the companies’ register maintained by the Chamber of Commerce.

Pre-Bankruptcy Composition

Conditions for Access to Pre-Bankruptcy Composition

Pre-bankruptcy composition is a court-supervised procedure, the purpose of which is to discharge the debtor’s debts and avoid bankruptcy. The debtor must submit a plan, which can provide for:

- The restructuring or discharge of debts in whatever form, including transfer of assets, assumption of debts or any other transaction, including the sale of assets to creditors.
in satisfaction of their claims, the issuance of shares, quotas or bonds (including convertibles) or other financial instruments;

- The transfer of the assets to a third party ("assuntore") who also assumes the debt; creditors of the debtor (or subsidiaries of such creditors) or new companies to be established during the course of the procedure, the shares of which are allocated to the creditors, can act as assuntore;

- The division of creditors into classes based on criteria (legal position, economic interests, etc.);

- Different treatment among creditors belonging to different classes.

A pre-bankruptcy composition plan is available to debtors who are in a "state of crisis" (which can be, but is not necessarily, insolvency).

In order to strengthen the position of the unsecured creditors Article 160 of the Italian Bankruptcy Law provides that the concordato proposal shall have to grant the payment of at least 20% of the unsecured creditors’ claims. This provision does not apply to concordato proposals that contemplate business continuation pursuant to Article 186-bis of the Italian Bankruptcy Law.

Persons Entitled to Submit a Pre-Bankruptcy Composition Plan

Only the debtor is entitled to submit a pre-bankruptcy composition plan and the relevant decision must be taken by the management body (usually the board of directors) of the company, which will then delegate one of its members to submit the plan.

Formalities of Filing for Pre-Bankruptcy Composition

The pre-bankruptcy composition plan must be submitted to the Bankruptcy Court of the district where the debtor has its main place of business in Italy.

Article 161 of the Italian Bankruptcy Law provides a list of items to be attached to the petition. In particular:

- An updated report of the assets and liabilities, and of the economic and financial situation, of the company;

- A list and assessment of value of the assets and a list of the creditors with an indication of their relevant claims and security interests;

- A list of creditors holding claims or rights, whether against the debtor or in rem (e.g. interests on assets owned or in possession of the debtor);

- A statement of the creditors and the value of the assets of any shareholders who have unlimited liability for the debtor’s debts;

- A plan containing an analytic description of the means and timing necessary for the implementation of the proposal (provision introduced by the Development Decree).

The restructuring plan and the documents indicated above must be accompanied by a report of a qualified professional (enrolled in the register of auditors and satisfying certain requisites) who is appointed by the debtor and who certifies the truthfulness of the company’s data and the feasibility of the restructuring plan.
The Bankruptcy Court ensures that the application for the composition with creditors is filed with the companies’ registry within the following day of the filing.

Moreover, in order to give the company in distress more time to prepare a viable concordato proposal, the Development Decree has also provided that the debtor may file an application for the composition with creditors simply attaching the latest three financial statements, postponing to a later time the filing of the proposal, the plan and the documents to be annexed thereto (“concordato in bianco”). These other documents must be filed within a term fixed by the delegated judge (from 60 to 120 days), which term can be extended by an additional 60 days maximum. During such period, creditors are prohibited to start or continue enforcement and foreclosure proceedings over the debtor’s assets (the “Automatic Stay”). The Automatic Stay will be extended for the whole period of the procedure if the debtor is admitted to the concordato. Therefore, from the date of filing of the petition until the moment at which the decree of homologation (described below) becomes final, no pre-procedure creditors may initiate or continue enforcement procedures against the assets of the debtor. If such an initiative is taken (or the procedure is continued), the action is null and void.

During the Automatic Stay period, the debtor has the option to switch from the pre-bankruptcy composition to a debt restructuring arrangement pursuant to Article 182-bis of the Italian Bankruptcy Law (discussed below), and it is empowered to carry out urgent acts for the company’s ordinary and extraordinary management subject to authorisation of the Bankruptcy Court. As indicated above, liabilities arising from the performance of such acts enjoy the highest priority (“prededucibilità”).

As a way to strengthen the effects of the Automatic Stay, the Development Decree has provided that any judicial (i.e. based on a judgment) mortgage registered in the companies’ register during the 90 days prior to the publication of the request for pre-bankruptcy composition is ineffective vis-à-vis the creditors at the time of filing of such an application.

In order to curb abuse of the pre-application and therefore too easy an access to the concordato, the Decreto del Fare has introduced some restrictions, namely higher information requirements and stricter control by the bodies of the procedure.

In particular, the debtor must now enclose a list of all creditors and relevant amounts owed. Moreover, the court may now appoint a judicial commissioner for the interim period (before the filing of the complete proposal) which will exercise control over the debtor in an effort to prevent the debtor from undertaking actions that might jeopardise the interests of the creditors.

A debtor applying for concordato is also required to periodically inform – at least on a monthly basis – the bodies of the procedure about the affairs of the company and the activities carried out for the implementation of the proposal. Non-fulfilment of such obligations may result in rejection of the application and declaration of bankruptcy, if the relevant requirements are met.

If the actions taken by the debtor are deemed inadequate, the court may shorten the deadline for filing the plan (or a debt restructuring arrangement pursuant to Article 182-bis).

Approval of Pre-Bankruptcy Composition Plan; Appointment of a Judicial Commissioner

Decrees of Admission and Homologation

If the Bankruptcy Court determines that the conditions are met, it will start the procedure, appoint a delegated judge and judicial commissioner (“commissario giudiziale”) and
schedule a creditors’ meeting within 120 days. The meeting can also be held by electronic means as set out in the recent Law Decree no. 59 of 3 May 2016.

At the creditors’ meeting the judicial commissioner illustrates the proposal made by the debtor in order to discharge his debts and those eventually made by the creditors. The unsecured creditors are then called to vote on the proposal. (Secured creditors do not vote, as they have priority over the proceeds of the sale of their security.) If the meeting is held by electronic means the discussion on the proposals made by the debtor and eventually by the creditors is regulated by a provision of the delegated judge issued at least 10 days before the meeting.

The pre-bankruptcy composition plan is approved if the proposal obtains the favourable vote of the majority of the unsecured creditors. Where creditors have been divided into classes, the favourable vote of a majority of the voting creditors of each class is required. Votes are counted according to the amount of the claims, not per capita. The Conversion Law no. 132/2015 abrogated the “implied consent rule”, according to which failure to vote was equal to approval, so that now all votes required for the approval of the proposal shall have to be explicitly cast (Article 178 of the Italian Bankruptcy Law).

After the approval of the proposal, dissenting creditors (or creditors belonging to a dissenting class) representing 20% or more of the liabilities may file an opposition, but the Bankruptcy Court can homologate (confirm) the plan nonetheless, if it is satisfied that dissenting creditors would not receive better treatment under the available alternatives (e.g. straight bankruptcy).

Before Decree no. 83/2015, creditors could only approve or reject the proposal but could not amend it. The aforesaid Decree now provides that creditors representing at least 10% of the claims against the debtor can file an alternative proposal, unless the independent expert attests that the debtor proposal grants the payment of at least 40% of unsecured creditors (or 30% in case of a business continuity composition). The creditors’ plan must be filed at least 30 days before the date set for the creditors’ meeting. This measure has been introduced in order to increase the competitiveness of pre-bankruptcy proceedings and therefore to maximise recovery for creditors.

Creditors will then vote on all plans and the plan approved with the highest majority shall prevail. In case of an equal number of votes, the debtor’s proposal shall prevail; otherwise, should the equal number of votes concern the alternative proposals, the plan which was filed earlier shall prevail.

After the creditors’ approval, the Bankruptcy Court homologates the pre-bankruptcy composition plan and appoints one or more liquidators in order to fulfil the approved plan, if it has to be realised by means of a transfer of assets. The decree of homologation must be issued within nine months of filing, subject to a 60-day extension. However, such terms are not mandatory.

In cases of breach of the pre-bankruptcy composition plan or fraud, bankruptcy may follow, at the behest of the Bankruptcy Court.

If the pre-bankruptcy composition plan is implemented, the debts are discharged and the debtor may return to ordinary operations (if the assets of the company are still in his possession).

Claims (including claims for repayment of loans, including up to 80% of the amount of shareholder loans) arising in the course of the implementation of the plan – not just after homologation but also before homologation (conditional upon the Bankruptcy Court
confirming such priority in the decree of admission) – are granted highest priority and must
be paid in full.

The aforementioned Conversion Law also states that, should the proposal include the sale of
the going concern or of one or more assets of the company to an identified third party, the
Court shall have to open a competitive auction procedure and boost the search of offerers in
order to maximise the value of the concerned assets.

Following the Development Decree, a debtor may also, subject to Bankruptcy Court
approval:

- Enter into first priority financing agreements to support the plan, even before having
  produced all the documentation to be filed together with the request of concordato
  pursuant to Article 161 of the Italian Bankruptcy Law. The Court’s authorisation is
  subject to a certification to be issued by an independent expert attesting that the new
  financing is instrumental to the satisfaction of the creditors. Such facilities may be
  secured by pledge, mortgage or by an assignment of receivables by way of security.

- According to Decree no. 83/2015, debtors are also entitled to obtain urgent interim
  finance which is necessary for their business needs without having to file a
  certification issued by an independent expert. The relevant claims shall take
  precedence over the other creditors’ claims in case of bankruptcy (“prededucibili”).
  The debtor must specify the purpose of the requested finance and declare that there
  are no alternative sources to obtain such financing and that failure to receive it will
  cause imminent and irreparable harm to its business. The Court shall decide on this
  request no later than 10 days from its filing after having heard the opinion of the
  judicial commissioner and, if necessary, also of the main creditors.

- Pay pre-existing claims relating to the purchase of goods and services, to the extent
  that the expert confirms that the purchase is essential for the continuation of the
  business activity and to ensure the best satisfaction of creditors.

Consequences of a Pre-Bankruptcy Composition

Effect of Commencement

Throughout the procedure, the debtor remains in possession and retains management
powers under the supervision of the judicial commissioner and the delegated judge.

Bankruptcy rules on monetary claims generally apply to the pre-bankruptcy composition
plan.

The Development Decree has also clarified that any act, payment or security executed or
created after the filing of the application for a pre-bankruptcy composition and in accordance
with its rules and procedures is not subject to clawback action.

Effect on Creditors

The creditors must file a proof of claim with the judicial commissioner. Any disputes
regarding these claims will be settled by the Bankruptcy Court.

The creditors’ participation in the proceedings is crucial, since they have to vote for or
against the debtor’s proposal at the creditors’ meeting. In principle, only unsecured creditors
are allowed to vote.
Effects on Contracts

According to case law, the provisions of Articles 72–83 of the Italian Bankruptcy Law on pending contracts do not apply. This conclusion has been drawn because these provisions are not quoted in the chapter of the Italian Bankruptcy Law regulating pre-bankruptcy composition plans, and the debtor still continues to run the business, under the supervision of the court and a judicial commissioner. As a consequence, any pending contract is governed by the ordinary rules, i.e. in case of breach by the debtor admitted in the pre-bankruptcy composition plan, the other party is entitled to terminate the contract.

However, the debtor may now seek Bankruptcy Court authorisation to terminate pending contracts which have not yet been performed at all or have been only partially performed; should the Bankruptcy Court grant the request, the debtor will have to pay in full an indemnification to the counterparty. The debtor may also ask the Bankruptcy Court to authorise a suspension of a contract for a term of 60 days that can be extended once by 60 more days.

Business Continuation Composition (“Concordato con Continuità Aziendale”)  

The Development Decree has introduced a new definition and regulation for all cases of pre-bankruptcy composition (most of which pre-existed and were widely used in the past) in which the proposal aims to ensure continuity of the business enterprise, whether by the same debtor or by a third party purchaser: the “business continuation composition” (“BCC”) (“concordato con continuità aziendale”). A concordato preventivo is a BCC if the proposal provides for: the continuation of the business by the debtor; the sale of the business as a going concern; or the contribution-in-kind of the business as a going concern to one or more companies (even if newly incorporated).

In these cases, the application must include a certification from an independent expert that the continuation of the business would maximise creditors’ satisfaction. Under this special concordato, payment to secured creditors can be postponed up to one year after homologation and executory contracts cannot be terminated by the other party by reason of the debtor being under a concordato (despite any provisions to the contrary in the relevant contract). Pursuant to the provisions enacted with the Decreto Destinazione Italia, debtors who filed a petition to be admitted to a BCC may participate in public bids provided that the Bankruptcy Court grants its authorisation after having heard the opinion of the judicial commissioner (Article 186-bis, fourth paragraph, of the Italian Bankruptcy Law).

In-Bankruptcy Composition  

The in-bankruptcy composition procedure (“concordato fallimentare”) is aimed at speeding up bankruptcy proceedings. During the course of a bankruptcy, the debtor, any creditor or a third party may propose an in-bankruptcy composition. The procedure is similar to a pre-bankruptcy composition plan; however, the debtor is entitled to propose a plan within one year after the adjudication of bankruptcy, provided that less than two years have lapsed from the date of issuance of the decree which approved the final creditors’ list (“stato passivo”).

A third party or one or more creditors proposing the in-bankruptcy composition (including an SPV formed for that purpose) acquires all assets included in the bankruptcy estate and assumes the relevant liabilities, thereby taking on the role of assuntore; the assumption is limited to the liabilities officially disclosed at the time when the proposal of in-bankruptcy composition is filed with the Bankruptcy Court.
Under Article 124 of the Italian Bankruptcy Law, the proposal for in-bankruptcy composition with creditors can include:

- The division of creditors into different classes and different treatments of different classes of creditors; and
- The restructuring of debts and the satisfaction of claims in any way, including by the sale of assets, assumption of debts or other extraordinary transactions.

The proposal may provide that the secured and preferred creditors will not be satisfied in full, on the condition that satisfaction is fixed at an amount not lower than the best possible price which may be obtained for the security on the market. The treatment provided for each class of creditors may not change the ranking of the preferred claims, as laid down by the law. No bonds or guarantees are required to back the commitments in the proposal; however, it is common practice to offer a bank guarantee to ensure that the contemplated payments are made.

As soon as the proposal for in-bankruptcy composition is filed with the Bankruptcy Court, the delegated judge seeks the bankruptcy receiver’s opinion (which is, however, not binding) and the approval of the creditors’ committee (which is for the homologation of the in-bankruptcy composition proposal). Secured creditors (unless they waive their priority) and creditors having a conflict of interest cannot vote. For example the proponent who is also a member of the creditors’ committee is not allowed to vote on his proposal. Failure to vote equals approval.

For the proposal to be approved, it must obtain the favourable vote (counted according to the amount of the claims, not per capita) of a majority of the creditors admitted to the vote (i.e. all unsecured creditors and secured creditors who waived their security interest or lien). In that respect, secured and preferred creditors who cast their votes are deemed to have waived their security interest or lien.

After the vote, the bankruptcy receiver presents a report to the delegated judge informing him of the outcome of the vote.

If the proposal is approved, the delegated judge orders the bankruptcy receiver to immediately notify the proponent of the approval in order to allow him to seek homologation of the plan and furthermore to notify the debtor and any dissenting creditors, and sets a term of between 15 and 30 days for the filing of possible oppositions (which can be filed by any interested party). Within the same term, the bankruptcy receiver must file a report detailing its final opinion on the proposal.

In case no opposition is filed within the terms fixed by the delegated judge, the Bankruptcy Court, after having verified the regularity of the procedure and the outcome of the vote, homologates the in-bankruptcy composition proposal by means of a decree which is final and not subject to appeal.

If oppositions are filed, the Bankruptcy Court sets a hearing in order to examine evidence requested by the parties (or ex officio). The decision is taken by the Bankruptcy Court by means of a motivated decree. The Bankruptcy Court’s decision on the opposition may be appealed before the Court of Appeal within 30 days of the date of service of the motivated decree on the relevant parties. However, the original decree is immediately enforceable even if subsequently appealed.

The in-bankruptcy composition can be terminated if the proponent does not post the (first demand bank) guarantee (customarily) contemplated in the proposal or breaches other
obligations. The in-bankruptcy composition may also be declared void if liabilities have been wilfully inflated or a part of the assets has been diverted or hidden.

**Debt Restructuring Arrangements pursuant to Article 182-bis**

The Italian Bankruptcy Law allows for debt restructuring arrangements ("accordi per la ristrutturazione di debiti"), whereby a debtor "in a state of crisis" enters into a composition with creditors which is binding on all the debtor’s creditors, provided that:

- The debt restructuring arrangement is agreed by creditors representing at least 60% of the value of the debts; and

- The reasonableness and feasibility of the debt restructuring arrangements, the truthfulness of the company’s accounting data and the suitability of such arrangements to ensure repayment of those creditors which did not agree with such arrangements are certified by an independent expert, who fulfils the requirements established in Article 67 of the Italian Bankruptcy Law.

In any case, the debtor must guarantee the full satisfaction of creditors who have not approved the arrangements.

The Italian Bankruptcy Law does not mandate a specific format for the debt restructuring arrangement. The parties can freely determine the specific obligations and how these are to be performed. For example, they may include the waiver of interest, guarantees, total or partial transfer of assets, different treatments between different classes of creditors or simple rescheduling.

The debt restructuring arrangement is subject to homologation (confirmation). To that end, it is recorded in the companies’ register; within 30 days of registration, creditors and any interested party may file an opposition. If the Bankruptcy Court considers that the aforementioned conditions are met and that oppositions, if any, are ill-founded, it issues a decree of homologation. If the Bankruptcy Court does not homologate the debt restructuring arrangement, it does not automatically declare the bankruptcy of the debtor ("state of crisis" does not necessarily coincide with insolvency).

According to the provisions introduced by the Development Decree, the payment of claims of creditors not adhering to the debt restructuring arrangement must occur: within 120 days of homologation if such claims are overdue; or within 120 days of their respective maturities if they are not yet due upon homologation.

The arrangement has to be published in the companies’ register and becomes legally binding on the day of publication.

During the phase of the filing with the court of the request for the formal confirmation of the debt restructuring arrangement, the company may request court permission to obtain new credit, which would be granted first priority and which may also be secured through pledge, mortgage or by an assignment of receivables by way of security. An opinion of an expert, certifying that the credit is “functional to the best satisfaction of creditors”, is required.

According to Decree no. 83/2015 the debtor is also entitled to obtain urgent interim finance which is necessary for its business needs without having to file a certification issued by an independent expert. The relevant claims shall take precedence over the other creditors' claims in case of bankruptcy ("prededucibili"). The debtor must specify the purpose of the requested finance and declare that there are no alternative sources to obtain such financing and that failure to receive it will cause imminent and irreparable harm to its business. The
court shall decide on this request no later than 10 days from its filing after having heard the opinion of the judicial commissioner and, if necessary, also of the main creditors.

A debtor that has made a preliminary filing for pre-bankruptcy composition and obtained the automatic stay (discussed above) may continue to benefit from the stay even if, instead of filing a formal proposal for concordato, it decides to propose a debt restructuring arrangement.

The Development Decree has also exempted debtors filing for homologation of a debt restructuring arrangement, from the minimum equity requirements under the Civil Code. Consequently, during the proceeding (after filing), directors are no longer under a duty to call a shareholder’s meeting in order for it to resolve upon such recapitalisation. (The same provisions apply to the pre-bankruptcy composition procedure).

Courts have interpreted in different ways the type of review that the Bankruptcy Court has to perform in order to homologate the debt restructuring arrangement. It is generally held that the Bankruptcy Court must primarily assess the reliability, logic and consistency of the expert’s report; given that most often the report will in turn rely on the likelihood of the occurrence of certain circumstances (e.g. new credit being granted). However, some Bankruptcy Courts have extended their scrutiny to such circumstances on which the report is based. The Bankruptcy Court of Milan in a case of 10 November 2009, while approving a plan despite the report being based on long-term conditions the reasonableness of which was impossible to assess, without any statutory basis gave the public prosecutor the task of monitoring the implementation of the plan.

Article 48 of Law Decree no. 78 of 31 May 2010, as converted by Law no. 122 of 30 July 2010, has strengthened the protection of the debt restructuring arrangement by allowing a debtor to seek a court-ordered moratorium during the course of the negotiations with creditors and before the approval of the arrangement itself. As mentioned above, during the moratorium no creditor is entitled to start or continue enforcement procedures or procedures aimed at obtaining precautionary measures or priority rights. In addition, the debtor must file with the competent Court: (i) a proposal of debt restructuring arrangement, accompanied by a self-certified declaration confirming that, between it and creditors representing at least 60% of its debt, negotiations on the proposal are pending; (ii) the documents requested for the pre-bankruptcy composition plan (see “Formalities of Filing for Pre-Bankruptcy Composition” above); and (iii) the declaration of an independent expert confirming the existence of the conditions to ensure the regular payment of creditors not included in the debt restructuring arrangement.

As soon as the above-mentioned documentation is filed and the request for moratorium is published in the companies’ register, the Bankruptcy Court verifies that the documentation is complete and schedules a hearing for discussion within 30 days from the filing of the request, ordering the transmission of the documentation to the creditors. During the hearing, the Bankruptcy Court verifies the existence of the conditions to approve the debt restructuring arrangement and decides by motivated decree. If the request is granted, the Bankruptcy Court issues the prohibition against starting or continuing enforcement procedures and procedures aimed at obtaining precautionary measures against the debtor, fixing a term not longer than 60 days for the filing of the debt restructuring arrangement.

Finally priority is granted to claims arising out of the implementation of the plan not only after homologation (this extends to shareholder loans, up to 80% of their value, as a departure from the general principle of subordination), but also prior thereto, during and prior to the filing phase, conditional upon such claims (e.g. new credit) being contemplated in the petition and the priority being confirmed by the court upon homologation.
It is worth pointing out that Decree no. 83/2015 has introduced Article 182-septies thus creating a special procedure as regards debt restructuring agreements involving mainly financial intermediaries. In particular, the restructuring agreement pursuant to Article 182-bis may indicate one or more categories of such banks/financial intermediaries having the same economic interests and legal position. In this case, the debtor can request to extend the effects of the executed restructuring agreement also to the minority of non-adhering financial creditors belonging to the same category, if: (i) at least 50% of the overall claims towards the company are vis-à-vis banks or financial intermediaries; (ii) the financial creditors who have executed the restructuring agreement represent at least 75% of the claims of the relevant category; (iii) the non-adhering creditors of the category have been informed of the negotiations and have been given the chance to participate. The Bankruptcy Court homologates the agreement after having ascertained the following:

- That negotiations have been carried on in bona fide; and
- That non-adhering banks and financial intermediaries:
  - have legal positions and economic interests similar to those of the adhering financial creditors;
  - have been provided with complete and updated information about the economic situation and financial position of the debtor, as well as about the contents and effects of the restructuring agreement; and
  - can be satisfied according to the agreement in a way which is not worse than the one which is likely to occur in case of any other concretely feasible scenarios.

The non-adhering creditors can challenge this extension if the aforesaid conditions are not met by filing a formal objection before the Bankruptcy Court within 30 days from the service upon them of the restructuring agreement.

A similar procedure is provided for by Decree no. 83/2015 in order to extend to non-adhering financial creditors also the effects of a standstill agreement executed prior to the restructuring agreement by the debtor and banks/financial intermediaries representing the aforesaid 75% majority. More specifically, this agreement shall also apply to creditors which did not take part in it provided that: (i) they have been informed of the negotiations and have been given the chance to participate; and (ii) an expert appointed pursuant to Article 67, third paragraph, letter d) has attested that all the creditors subject to the standstill have the same legal position and economic interests. The non-adhering creditors can challenge this extension by filing a formal objection within 30 days from the service upon them of the executed standstill agreement.

Tax Legislation

In the case of a debt restructuring agreement that has been formally validated by the Bankruptcy Court, any agreed reduction of the company’s liability shall not constitute a taxable gain.

Turnaround Plans pursuant to Article 67(3)(d)

As discussed above, the law governing turnaround plans ("piani attestati di risanamento") provides an exemption from clawback for contracts, payments and security on the debtor’s assets where these have been put in place in furtherance of a plan to bring the debts and the financial situation back under control and an expert has certified the "reasonableness" of the transaction. In particular, as provided by the recent Development Decree, the expert
must certify the trustworthiness of the company’s financial data and the feasibility of the plan. An expert who provides false information or omits to communicate relevant information may be criminally liable.

Because these arrangements are not formally approved by the Bankruptcy Court, the debtor does not run the risk of informing the court of its possible insolvency, which, in the case of debt restructuring arrangements, could ultimately lead to a declaration of bankruptcy. For this reason, and because the debt restructuring arrangement did not add much protection or advantage, these agreements under Article 67 have so far had much more success than debt restructuring arrangements.

**Tax Legislation**

As long as a turnaround plan has been published in the companies’ register, any agreed reduction of the company’s liabilities shall not constitute a taxable gain.

**Extraordinary Administration**

**Requisites for the Admission**

Extraordinary Administration (‘amministrazione straordinaria delle grandi imprese in stato di crisi’), which is regulated by Law no. 270 of 8 July 1999 (‘Prodi-bis Law’), replaces the previous special administration for large companies in state of crisis (“amministrazione straordinaria delle grandi Imprese in crisi”), introduced by Law no. 95 of 3 April 1979 (‘Prodi Law’). The benefits of the Extraordinary Administration are available only to companies (and their affiliates): that had at least 200 employees in the previous year; and with total liabilities of at least two-thirds of either its total assets or its turnover in the previous financial year.

The procedure is divided into two phases:

- The first phase leads to the declaration of the state of insolvency (to be verified on the same basis as bankruptcy); and
- The second phase, resulting in the admission of the insolvent company to the extraordinary administration procedure or, alternatively, to adjudication in bankruptcy.

**Commencement of Extraordinary Administration**

**The First Phase – Declaration of the State of Insolvency**

The first phase is mainly focused on the ascertainment of the requisites for the admission of the debtor to Extraordinary Administration and is aimed at the declaration of the state of insolvency.

The procedure for the declaration of the state of insolvency is commenced by a petition filed by: the debtor; any of the debtor’s creditors; the public prosecutor; or the Bankruptcy Court itself (ex officio).

If the request is filed by the debtor, in its petition to the court it must illustrate the reasons for the insolvency and supply all relevant information regarding the existence of the aforementioned requirements.

The following documents, *inter alia*, must be attached to the application: the debtor’s accounting records; the balance sheet for the previous two years; an up-to-date financial statement; a list of all the debtor’s creditors; and a list of creditors having rights over moveable assets in the debtor’s possession.
Should the requisites for the admission to Extraordinary Administration be satisfied, the Bankruptcy Court where the debtor has its main place of business declares the state of insolvency. In its judgment, the Bankruptcy Court: appoints the delegated judge who will supervise the procedure and one or three judicial commissioners; sets the deadline for the creditors to present their proofs of claim and the date of the hearing at which such claims will be examined by the delegated judge; and decides whether the management of the insolvent company should remain with the debtor or pass to one or three judicial commissioners (a panel of judicial commissioners is appointed in cases of exceptional relevance and complexity of the procedure). Such a decision is discretionary and involves a case-by-case determination whether is appropriate for the debtor’s management to remain in possession, based on a judgment of what they would do if they remain in possession, on the basis of their track record and all foreseeable circumstances. In principle, based on some relevant precedents, the management of the enterprise is generally passed to the judicial commissioner. The judicial commissioner acts as a public officer. If three judicial commissioners are appointed, they make decisions by majority and one of them is named legal representative of the insolvent company. The Bankruptcy Court can dismiss the petition if the statutory conditions are not met. In such cases, the Bankruptcy Court declares the debtor bankrupt.

The Second Phase – Opening of the Procedure

Following the declaration of insolvency, the large company is eligible to be admitted to the benefits of Extraordinary Administration.

Pursuant to Article 27 of Law no. 270, this procedure is open solely to companies which demonstrate “concrete possibilities of recovery of economical balance of their activities”. Pursuant to the second paragraph of Article 27, the debtor submits a recovery plan. The recovery contemplated may be achieved through the transfer of the debtor’s business, after a year of continued operation, or an economic and financial restructuring of the debts.

The evaluation of whether these prerequisites have been met is made by the Bankruptcy Court that declared the state of insolvency on the basis of: a report made by the judicial commissioner(s) and filed with the Bankruptcy Court within 30 days of the declaration of the state of insolvency; and the opinion of the Ministry of Economic Development, to be filed within 10 days after receipt of the extraordinary commissioner’s report.

Within 30 days of the filing of the judicial commissioner’s report, and taking into account the opinion of the Ministry of Economic Development, the Bankruptcy Court, should the conditions provided by Article 27 of Law no. 270 be met, declares the opening of the procedure. Otherwise, it declares the debtor company bankrupt.

The procedure is conducted by one or three extraordinary commissioners under the supervision of the Ministry, except for some specific decisions which are expressly reserved to the delegated judge and the Bankruptcy Court.

The extraordinary commissioners are appointed by the Ministry within five days of the decree opening the procedure. The extraordinary commissioners have the power to manage the company and its assets under the supervision of the Ministry. They act on the basis of a recovery plan prepared by them and authorised by the Ministry after consultation with a surveillance committee (“comitato di sorveglianza”) composed of members chosen from among the unsecured creditors and persons with specific expertise in the field of activities of the debtor. The surveillance committee gives its opinion on the most important actions to be taken by the extraordinary commissioners and whenever else the Ministry deems it appropriate.
At any time during the procedure, if any statutory conditions are not fulfilled the extraordinary administration can be converted into bankruptcy.

Effect of Commencement of the Extraordinary Administration

The declaration of the state of insolvency produces certain immediate effects, such as the automatic stay of all legal actions by creditors against the debtor’s assets and the freezing of the accrual of interest.

The procedure also affects pending contracts. Article 50 of the Law no. 270 provides that the extraordinary commissioner has the discretion to continue or terminate any contract which has not been performed in whole or in part by either party, at any time during the procedure. Until the judicial commissioner takes such action, the contract remains in full force and effect. After approval of the recovery programme, the other party to the contract can request that the extraordinary commissioner notify him within 30 days of his decision whether to continue or terminate the agreement. In the absence of a response from the extraordinary commissioner, the contract is deemed to be terminated. This termination does not occur with respect to employment agreements and lease agreements regarding real estate property where the debtor is the lessor. As regards the rights of the other party, the rules of the Italian Bankruptcy Law regarding the status of contracts in the event of bankruptcy are applicable.

The effects of the admission to the extraordinary administration (second phase) are that the stay of actions continues and clawback actions become possible. Debts incurred in the continuation of the business generally will have priority over any other secured and unsecured claim (“in prededuzione”) pursuant to Article 111 of the Italian Bankruptcy Law.

In an effort to better coordinate procedures and avoid fraudulent transfers, Article 8.3(c) of Law-Decree no. 70 of 13 May 2011, as converted by Law no. 106 of 12 July 2011, has introduced a new Article 50-bis, which addresses the situation where: an enterprise or portion thereof has been transferred prior to insolvency; the property transferred constitutes the major part of the assets of the transferee; and the transferor and the transferee both become insolvent within a year from the transfer and are both subject to extraordinary administration procedures. In such a case, the transferor is jointly liable with the transferee for all debts and liabilities incurred after the transfer. Also, in such case the Ministry of Economic Development may appoint the same commissioners for the two procedures. The new law also empowers the Ministry to issue guidelines to ensure that the programmes for the two procedures are coordinated.

Administration of the Procedure

The Court

The Bankruptcy Court of the debtor’s main place of business is competent for the declaration of the state of insolvency as well as for the initiation of the extraordinary administration procedure. All legal actions arising out of the declaration of the state of insolvency must be submitted to this court.

During the first phase, a delegated judge appointed in the judgment declaring the state of insolvency has certain authority, the extent of which depends on whether the debtor remains in possession. During the second phase, the delegated judge has more limited powers, in that he is only responsible for the admission of the creditors’ claims and the distribution of any liquidation proceeds.

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3 Such clawback actions are only possible if the recovery program envisages the transfer of the debtor’s business.
Appointment of Commissioners

As illustrated above, one or three judicial commissioners are appointed during the first phase. Like the delegated judge, the judicial commissioners’ duties depend on whether the debtor remains in possession.

If the debtor is admitted to the second phase, extraordinary commissioners are appointed by the Minister of Economic Development to manage the debtor’s operations under the Minister’s supervision on the basis of the recovery program previously prepared by him.

According to Article 8.3 of Law-Decree no. 70 of 13 May 2011, the Ministry for the Economic Development, in conjunction with the Ministry for Economy and Finance, lays down the rules for the remuneration of commissioners and members of the surveillance committee, which must be based on results obtained, achievement of the objectives set in the programme and creditors’ satisfaction.

Government Agencies

The Ministry of Economic Development plays an important role both in relation to the admission of the debtor to the second phase, in that it is called to express its opinion as to the existence of the conditions for the recovery, and during the entire second phase, since it appoints, and supervises the activities of, the extraordinary commissioners. Certain transactions, such as transfers of business undertakings or of real estate, require the approval of the Ministry. The Ministry can appoint experts and can deploy tax police ("guardia di finanza") for the necessary controls and investigations and adoption of the necessary actions.

Creditors

The unsecured creditors are exclusively represented by one or two members of the surveillance committee, which has consulting duties.

Creditors can file their proofs of claim and have right to distribution of proceeds.

Creditors can also oppose the declaration of the state of insolvency as well as the admission to the second phase.

Under Article 53 of Law no. 270, the rules established by the Italian Bankruptcy Law regarding the creditors’ proofs of claim also apply to the extraordinary administration.

Recovery Program

The work-out is based on a recovery programme ("programma di ristrutturazione"), which, as already illustrated, is prepared by the extraordinary commissioner(s) within 60 days of the decree opening the procedure. The programme can be based on either the transfer of the debtor’s business, after one year of continuation of the operations, or on an economic and financial restructuring of the large debtor on the basis of a restructuring plan not exceeding two years. This programme must be approved by the Ministry of Economic Development and implemented by the extraordinary commissioners by carrying out all planned restructuring activities. The programme can also be amended or replaced in the course of the procedure with the approval of the Ministry.

More specifically, the recovery programme must contain: (i) an indication of the core business on which the company’s recovery should concentrate; (ii) a plan for liquidating the assets that are not strategic for the business; (iii) an indication of the financial resources required to support the implementation of the procedure; and (iv) the economic and financial expectations and goals of the continuation of the business.
Failure

The Extraordinary Administration can at any time be converted into bankruptcy upon request by the extraordinary commissioner, or even *ex officio*, if the procedure cannot be positively continued. At the end of the procedure, upon request of the extraordinary commissioner or even *ex officio*, the Bankruptcy Court will declare the conversion of the procedure into bankruptcy when either the sale of the assets has been not performed within the term stipulated in the programme, or the business has not recovered its ability to regularly perform its obligations.

Completion and Termination

Should the recovery programme underpinning the transfer of the business be completed within the term set, the Bankruptcy Court, upon request of the extraordinary commissioners or *ex officio*, declares the closing down of the business. The decree is communicated to the Ministry of Economic Development and to the companies’ register by the clerk office.

The procedure can also end if: no creditors have presented claims; the entrepreneur has recovered his capacity to regularly satisfy his liabilities; the debtor has applied for in-bankruptcy composition and the application has been finally approved; all claims have been satisfied in full; or the proceeds from the assets’ liquidation have been entirely distributed.

The Marzano Decree

In the wake of the Parmalat case, the Marzano Decree introduced a faster procedure aimed at saving and turning around large insolvent companies in order to preserve their technical, commercial, productive and employment value. This procedure restructures the company’s debts and sells those assets that are not strategic or do not form part of the company’s core business.

The extraordinary administration procedure under the Marzano Decree introduced the following innovations:

- The debtor must apply to the Minister of Economic Development for immediate admission to the procedure, while at the same time filing a petition with the Bankruptcy Court in order to confirm its insolvency status. It is the Minister, rather than the Bankruptcy Court, that has chief responsibility for supervising the procedure; the Bankruptcy Court is requested only to confirm the company’s insolvency status and verify the lawfulness of the proceeding with respect to the verification of claims;
- If the debtor is admitted to the procedure, other insolvent companies in the same corporate group may also participate, even if they do not satisfy the relevant requirements;
- The procedure is focused on restructuring rather than on the liquidation of the debtor’s assets. It is based on the implementation of a two-year recovery plan subject to the Minister’s approval. The restructuring plan may be converted into a sale plan – and/or into a bankruptcy procedure – if the Minister does not authorise the implementation of the restructuring plan;
- The recovery plan can provide for the satisfaction of creditors’ claims through a composition, which must specify any conditions of its implementation and describe any offered guarantees. The composition can consist of:
  - the restructuring of debts and satisfaction of creditors’ claims through any technical or legal means, including the assumption of debts, mergers and
other corporate transactions; in particular, the composition can allow for the allocation to creditors (or classes of creditors) of stock, quotas or bonds, including convertible bonds, or other financial instruments;

- the transfer of the assets of all companies involved in the proposed composition to a third party;
- the division of creditors into classes, according to their legal position and uniform economic interests and the different treatment of creditors belonging to different classes;
- the transfer of clawback actions to a third party;

The extraordinary commissioner may bring clawback actions for the benefit of creditors during the implementation of a recovery plan. In contrast, in cases of extraordinary administration, as regulated by Law no. 270, clawback actions are possible only where a sale plan is established.

**Forced Administrative Liquidation**

Forced Administrative Liquidation is a special bankruptcy procedure provided by the Italian Bankruptcy Law (Articles 194−213 and numerous special laws) for some types of enterprises – in particular, it applies to insurance companies, credit institutions, cooperative companies (“società cooperative”), trusts and auditing companies, cooperative consortia (“consorzi di cooperative”) granting public contracts, mandatory consortia (“consorzi obbligatori”), and in other cases contemplated by special laws. Its aim is to liquidate the debtor.

The debtor, the directors of an insolvent company, or one or more creditor(s) may apply to the Bankruptcy Court. The Bankruptcy Court must seek the advice of the government agency responsible for supervising the debtor’s enterprise. The judge may initiate proceedings by declaring the debtor insolvent and appointing a liquidator. All legal actions by creditors against the debtor are then stayed, with the exception of those aiming to ascertain the amount of any claim.

The liquidator acts as a public officer and is assisted by a supervisory committee consisting of between two and five experts (who may or may not be creditors) in the debtor’s industry. In the case of large businesses, up to three liquidators may be appointed. Unlike other procedures, there is no delegated judge, as the procedure is mainly administrative in nature.

The liquidator must review claims and consider whether a composition is feasible. If so, he will prepare with the debtor a plan of repayment, to be submitted to the creditors. If a composition does not appear feasible, arrangements are made for the disposal of the debtor’s assets and the distribution of proceeds among the creditors in the same order of priority as in bankruptcy.

**Directors’ Duties and Liability**

Directors have a general duty to prudently manage the company, in compliance with laws and regulations, and owe their shareholders a fiduciary duty. Directors are jointly and severally liable for breach of their duties, except where one can establish lack of fault.

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4 This procedure is compulsory for banks, while in the case of other public entities it is an alternative to bankruptcy. The evolution of Italian legislation has led to the extension of the banking model to other financial institutions, such as investments firms (“SIM”), fund management companies (“SGR”), and open-end investment companies (“SICAV”), and to financial intermediaries disciplined by Article 107 of the Italian Banking Law.
A claim may be brought against a director by the company, a shareholder or a creditor who has suffered a loss as a consequence of the director’s fault. If the company is bankrupt or subject to any analogous procedure, the claim may be brought by the bankruptcy receiver.

Where a director has breached the law or articles of association (e.g. has failed to act with normal diligence in supervising the conduct of the company’s affairs, has failed to do his best to prevent the occurrence of prejudicial acts or reduce their harmful effects or has acted in conflict of interest), and the company suffers damage as an immediate and direct consequence, the director is personally and jointly liable to the company for the damage suffered.

Directors are under a duty to call a meeting without delay in the event that the equity capital decreases by more than one-third because of the company’s losses. It is unusual for a court to find liability for this breach, due to the difficulty in proving causation. However, courts may impose liability for negligent mismanagement in not having acted to prevent losses.

Duties imposed on directors apply equally to those who, although not formally appointed to the office, carry out de facto management activities or are involved in the running of the company.

Extraterritorial Jurisdiction/Enforceability

Recognition of Foreign Insolvency Proceedings

Italian Courts may recognise the existence of foreign insolvency proceedings or an order of a foreign Bankruptcy Court, provided that the following principles are satisfied:

- The foreign court has international jurisdiction over the case; and
- Such foreign proceedings or orders do not produce effects which are contrary to Italian public policy (“ordre public”).

Neither the Italian Bankruptcy Law nor Law no. 218 of 31 May 1995 concerning the modification of the Italian system of international private law contain any specific rule relating to international jurisdiction over insolvency proceedings.

Additionally, Council Regulation (EC) no. 44 of 22 December 2001, on jurisdiction and recognition and enforcement of judgments in civil and commercial matters (both enforced in Italy), cannot be applied to bankruptcy, winding-up proceedings, judicial arrangements, composition and analogous proceedings. Nor has this provision been amended by Regulation no. 1215/2012 of the European Parliament and of the Council dated 12 December 2012.

Article 3, paragraph 1, of the Council Regulation (EC) no. 1346 of 29 May 2000 (the “EC Bankruptcy Regulation”) provides that the court of the member state “within the territory of which the centre of the debtor’s main interests is situated” is competent to commence the

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5 Italian legal commentators distinguish between “international public policy” (which refers to the general principles that are universally enforceable, namely the inviolable rights of the individuals) and “internal public policy” (which includes the ethical, economical, political and social principles peculiar to the Italian legal system). Only the first is relevant with respect to the recognition of proceedings.

Article 26 of the EC Bankruptcy Regulation prevents any member state from recognizing an insolvency proceeding and enforcing a judgment relating to it if they are manifestly contrary to the relevant state’s public policy, “in particular to its fundamental principles or the constitutional rights and liberties of the individual”.

It is worth underlining that Article 26 of the EC Bankruptcy Regulation contains a general definition of “international public policy”, which is deemed to be the fundamental principles of any member state, as well as the constitutional rights and liberties of the individual.
main insolvency proceedings. “Centre” refers to, in the case of a company or legal entity, the place of its registered office.\(^6\)

As set forth in Article 3, paragraph 2, the courts of a member state in which the debtor has a permanent establishment can initiate secondary insolvency proceedings against a debtor whose centre of main interests is within another member state. In such an event, the effects of the secondary proceedings are limited to the assets situated in the territory of the first member state and aimed at the liquidation of the insolvent company.

On 20 May 2015, the European Parliament and the Council enacted the EU Regulation no. 848/2015 (the “Recast Bankruptcy Regulation”), which entered into force on 25 June 2015 and will be applicable to insolvency proceedings starting from 26 June 2017, with few exceptions (Articles 24, first paragraph, 25 and 86). The new rules also apply to proceedings which provide for the restructuring of a debtor, the so-called “hybrid proceedings”, for example the Italian debt restructuring arrangements pursuant to Article 182-bis of the Bankruptcy Law.

This reform does not change the main framework of cross-border insolvency proceedings as set out under the EC Bankruptcy Regulation, but anyway introduces some important changes. The aforementioned “centre of the debtor’s main interests” pursuant to Article 3 has been more precisely defined as the “place where the debtor carries on the administration of its interest on a regular basis and which is verifiable by third parties”.

Another important amendment is set forth by Article 4 of the Recast Bankruptcy Regulation, stating that the court before which a request to start insolvency proceedings has been filed shall have to examine ex officio whether it has jurisdiction on the case. Should the court decide to open the proceedings, it shall have to specify in its decision if the proceedings are the main proceedings or secondary proceedings, pursuant to Article 3.

Immediate recognition of the foreign bankruptcy judgments and measures are denied by Italian courts (only) if they may produce effects that are contrary to Italian public policy, for example, if they do not grant all creditors equal treatment.\(^7\)

Where the EC Bankruptcy Regulation is not applicable, Italian Bankruptcy Law applies. Article 9, paragraph 1 provides that bankruptcy can be declared by the court of the place where the debtor has its “main office”. In order to give emphasis to the notion of “main office”, Italian case law does not make reference to the place where the productive activity is usually carried out, but to the management centre of the business, i.e. the place where the business decisions of the company are taken.

Pursuant to Article 9, paragraph 2, the transfer of the registered office of a company in the year prior to the filing of the petition for bankruptcy is disregarded for the purpose of determining the venue and jurisdiction of the bankruptcy proceedings of such company.

According to Article 9, paragraph 3, the debtor who has its main office abroad can be declared bankrupt in Italy, even if a declaration of bankruptcy has been rendered abroad. Furthermore, the relocation of the business to a foreign country does not exclude the jurisdiction of Italian courts, if it occurred after the filing of a petition for bankruptcy or the request of the Public Prosecutor.

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\(^6\) Pursuant to Article 2(a) and (c) of the EC Bankruptcy Regulation, insolvency proceedings which may be commenced in Italy are the fallimento, concordato preventivo, liquidazione coatta amministrativa and amministrazione straordinaria. The fallimento and liquidazione coatta amministrativa are considered to be “liquidation proceedings”.

\(^7\) Corte di Cassazione, judgment no. 12031 of 19 December 1990.
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Japan

Overview and Introduction

Japanese insolvency laws have undergone significant reform since 1996, particularly in the past decade. The changes addressed a number of problems under the old laws, including widespread complaints of debtor abuse, minimal court oversight of proceedings, overly strict requirements to commence proceedings and to confirm Reorganisation plans, difficulty in obtaining temporary restraining orders pending the commencement of proceedings, a lack of restrictions on secured creditors, and a lack of avoiding powers. This chapter will introduce the relevant legislation in the field of insolvency, out-of-court workouts, as well as ADR for business rehabilitations (“Turnaround ADR”).

Applicable Legislation

Four insolvency laws in Japan provide for court proceedings. Two of these are intended to facilitate the rehabilitation of the debtor and two are terminal proceedings that result in the liquidation and dissolution of a corporation or a “blank slate fresh start” for an individual.

The Corporate Reorganisation Law (the “RL”), which was introduced in 1952 and modelled on Chapter X of the US Bankruptcy Act of 1898, was reformed most recently in 2003. In order to facilitate effective rehabilitation, the RL includes significant restrictions on creditors’ rights, whether secured or unsecured, but requires the appointment of a reorganisation trustee to manage the corporation during the proceedings.

The Civil Rehabilitation Law (the “CRL”) was introduced in 2000 to replace the Composition Law, which was seen to have several shortcomings. An important feature of the CRL is its “debtor in possession” ("DIP") system, in which the management of a debtor oversees its own reorganisation under court supervision. In addition, the CRL provides special treatment for an individual debtor's housing loan.

Terminal proceedings may take place under the Bankruptcy Law, which was reformed most recently in 2005, or under the Special Liquidation chapter of the Companies Act, which was reformed in 2006. Bankruptcy proceedings provide only for the liquidation of a corporate or individual debtor’s assets. Special liquidation proceedings are intended to facilitate and streamline the liquidation of a corporation without a court-appointed trustee and this process has been utilised as a means of liquidating subsidiaries of a conglomerate company.

There are also a few out-of-court mechanisms that are available to financially troubled corporations in addition to the statutory proceedings. The most well-known mechanism is the Guidelines for the Out-of-Court Workout for Multi-Financial Institutions, under which a debtor corporation may apply directly to major banks to develop a reorganisation plan. Out-of-court mechanisms are also available when financially troubled corporations ask for help from government related corporations such as the Resolution and Collection Corporation (“RCC”).

Under either the statutory proceedings or the out-of-court mechanisms, financially troubled corporations can make use of several rehabilitation methods. For example, debt-to-equity swaps (“DES”), corporate recovery funds, DIP financing, restructuring advisory services, and turnaround managers are methods of revitalising a corporation alongside the restructuring of debt obligations.

Personal Bankruptcy

Individuals who face bankruptcy may avail themselves of two of the insolvency laws. In the event of bankruptcy, when an individual is unable to make debt payments when they
become due, the bankrupt individual may petition for proceedings under the Bankruptcy Law. In the case of consumer debt, individuals are often discharged of their debt. Bankrupt individuals with more substantial liabilities, such as corporate CEOs, will often be subject to full proceedings. In these cases, a trustee is appointed to oversee the liquidation of the bankrupt individual’s assets so that the proceeds of the liquidation of their assets may be distributed to creditors on a pro rata basis according to the priority of the creditors’ claims.

However, bankrupt individuals are allowed to exempt three months’ family household expenses (currently JPY 990,000) from the bankruptcy estate that is to be distributed to creditors. Ultimately, liquidation with a modest cash exception or the discharge of consumer debt gives the debtor an opportunity for a “fresh start”. Bankruptcy proceedings will be discussed in greater detail below in the context of corporate insolvency.

An individual debtor may also petition for the commencement of a proceeding under the CRL in order to avoid a proceeding under the Bankruptcy Law. The CRL proceeding allows an individual, with the help of a court-appointed rehabilitation supervisor, to propose a plan to creditors to discharge excessive debts in exchange for paying a portion of the debt from income for a fixed period of time. This option is available to individuals who are likely to have income on a regular basis and whose total amount of debt is JPY 50 million or less, excluding housing loans and other debts secured by a lien. A special rule exists to protect individual debtors who own houses, whereby a debtor who can pay both principal and interest may, in certain circumstances, reschedule the repayment terms of the housing loan.

Corporate Restructuring and Insolvency
Reorganisations, Restructurings and Work-Outs

Financially distressed corporations in Japan may seek reorganisation or rehabilitation with or without court assistance. Each of the court-based proceedings has unique features that might appeal to different types of debtors. For example, one corporation might opt for a Civil Rehabilitation proceeding in order to keep existing management during the proceeding, whereas another corporation might opt for a Corporate Reorganisation proceeding in order to bind secured creditors into the proceeding as well as to manage the corporation by a court-appointed reorganisation trustee. Alternatively, a company may wish to pursue an out-of-court work-out in order to deal with its financial troubles more quietly and privately under certain conditions.

Corporate Reorganisation Proceeding

This proceeding applies only to stock corporations. There are three types of applicants who can file for the commencement of a proceeding under the RL:

- A debtor;
- A creditor with an aggregate amount of claims that is at least 10% of the debtor’s paid-in capital; and
- A shareholder with an aggregate amount of voting shares that is at least 10% of the total voting shares of the debtor corporation’s paid-in capital.

The debtor may file a petition if payment of debts, when they become due, would significantly impair the debtor’s business operations or if the debtor is in danger of bankruptcy. The creditor or the shareholder may also file a petition if the debtor is in danger of bankruptcy. The requirements of “bankruptcy” are defined under the Bankruptcy Law as being either when a debtor cannot pay its debts when they become due or when liabilities exceed the assets of the debtor (the balance-sheet test). When the court determines that
one of these conditions has been met, the court issues a commencement order and appoints a reorganisation trustee. While the appointed trustee is usually a qualified lawyer, the RL allows the court to appoint a former management director as long as this person was not responsible for potential damage claims which might be pursued for any business failure caused by the debtor’s management, major creditors do not object to such appointment and other requirements are met. Once appointed, the trustee manages the distressed corporation and makes and executes a reorganisation plan until the case is closed.

The RL provides several forms of assistance to the debtor. The first set of measures is aimed at protecting the debtor’s assets in the period of time between the filing of a petition under the RL and the issuance of the commencement order.

- First, upon the filing by the debtor, a creditor or a shareholder, the court will often issue preservative injunctions. These injunctions typically prohibit the debtor from paying pre-injunction debts, disposing of the debtor’s assets and borrowing money.

- Second, in addition to or instead of the above injunctions, the court will often issue an interim administration order to appoint an interim trustee and an examiner before a reorganisation trustee is appointed with the commencement order. The interim administration order restricts the interim trustee in the same way as the preservative injunctions.

- Third, because the above measures are directed only at the debtor’s actions, the court may issue a “cease and desist order” that prevents or halts foreclosures or other proceedings against the debtor.

- Fourth, under special circumstances in which a cease and desist order is not sufficient, the court may issue a more powerful order against creditors, namely a “comprehensive prohibition order”, to prohibit creditors from pursuing pre-injunction claims. This order may be made under the 2003 reform to the RL.

Once the court issues a commencement order, the RL provides a second set of measures to protect the debtor’s assets during the Corporate Reorganisation proceeding. Most importantly, the debtor is prohibited from making any payments of debts that are owed before the time of the commencement order. All creditors must file a proof of claim to be examined and allowed before becoming eligible to receive any payment during the proceeding.

One of the most significant features of a Corporate Reorganisation proceeding is that secured claims are subject to the same restrictions as unsecured creditors. The court further limits the extent of secured claims to the value of the collateral (usually real estate), and when necessary for the debtor’s Reorganisation, the court may extinguish the security claim by allowing the debtor to pay the value of the collateral to the court. The amount paid is either used for the purpose of the debtor’s business with supplemental security for the secured creditor or paid to this creditor after the court confirms a Reorganisation plan.

In addition, the RL gives the trustee the power of avoidance in order to void certain sales of the debtor’s assets that were made while the debtor was in a financially distressed condition. The purpose of this avoidance is to ensure that all creditors are treated equally while the debtor is in such condition. The power of avoidance allows the trustee to avoid obligations that arose out of transactions characterised as “fraudulent conveyance” or “preference”.

Finally, the court may approve and issue an order for the assignment of all or part of the debtor’s business if such assignment is necessary for the successful restructuring of the corporation before, on, or after the creditors’ meeting for voting on the Reorganisation plan.
The Reorganisation trustee asks the court to assign the part of the business that is necessary to reorganise the debtor before the creditors’ meeting that is held for acceptance of the Reorganisation plan. While creditors are entitled to a hearing that may affect the court order, shareholders who hold more than one-third of voting shares can veto this assignment if the debtor is not in the condition of balance-sheet insolvency (liabilities exceed assets). The assignment of the business could be included in the Reorganisation plan that is accepted at the creditors’ meeting and confirmed by the court. (The procedure for acceptance and confirmation is described below.) The Reorganisation trustee should change the confirmed Reorganisation plan if he intends to assign the business and the assignment was not included in the plan. Generally, the proceeding in regard to this change is similar to that of accepting and approving the original plan.

The RL also provides some protection for creditors’ rights. One of the protections is for administrative claims including wages for the debtor’s employees, fees for the Reorganisation trustee and costs for operating the corporation after the filing under the RL. These claims may be paid at any time without being based on the Reorganisation plan and are completely different from the Reorganisation claims, either secured or unsecured, which should be repaid in accordance with the confirmed Reorganisation plan. The court may permit the payment of claims not under the Reorganisation plan that are essential to the continuation of business either by the creditor or the debtor, and the court may also permit the payment of small claims in order to reduce a large number of creditors, which facilitates the process of the proceedings. In addition, the RL allows creditors the right of set-off, by which a creditor may set off a debt that it owed to the debtor at the time of the commencement order against a claim that it has against the debtor; provided, however, that the RL prohibits the creditors’ from setting-off under certain circumstances.

The goal of the proceedings under the RL is to formulate and implement a Reorganisation plan that revitalises the debtor corporation and provides reasonable repayment to creditors. A plan is usually submitted by the trustee; however, a recent trend is that numerous creditors have begun to submit their own plans to attempt to obtain more favourable repayment conditions. The plan must be confirmed by the court after the creditors’ meeting that accepts the plan. Acceptance of the plan requires each of the following votes of approval (note that voting rights are allocated based on the amount of the claim, not the number of creditors or claims):

- More than half of the total voting rights for unsecured creditors;
- Two-thirds or more of the total voting rights for secured creditors if the plan provides for the extension of due dates of secured claims; and
- Three-quarters or more of the total voting rights for secured creditors if the plan provides for a “haircut” (debt forgiveness) or other adverse consequences for secured creditors (other than an extension of due dates).

The proceedings are terminated when the plan is performed in its entirety or when the court is convinced that it will be performed. Generally, secured claims have the highest repayment priority, followed by unsecured claims. The distribution rate for each secured claim is usually 100% without interest. Distribution rates for unsecured claims depend on the case in question. The reformed RL also establishes the concept of contractual subordinated claims, which allows the claims to be paid after completing payment for claims that are to be paid prior to the subordinated claims. Shareholders have no voting rights if the debtor’s liabilities exceed the assets, which occurs in most cases. Shareholders have the lowest priority and usually cannot receive any distribution based on the Reorganisation plan.
Civil Rehabilitation Proceeding

A corporate or individual debtor or a creditor may petition for the commencement of an insolvency proceeding under the CRL. The debtor may file a petition if payment of debts when they become due would significantly impair the debtor’s business operations or if the debtor is in danger of bankruptcy, while the creditor may file a petition if the debtor is in danger of bankruptcy, as described above in “Corporate Reorganisation Proceeding”. When the court determines that one of these conditions has been met, the court will issue a commencement order.

The CRL proceeding uses a DIP system in which the debtor maintains its own management under the court’s supervision. Depending on the situation, the court can appoint a supervisor or an examiner, and it can allow an official creditors’ committee to participate in the proceedings. The Tokyo District Court usually appoints a supervisor but has rarely received a request to allow an official creditors’ committee to be formed. The main reason for not receiving such a request may be that members of the committee are compensated from the debtor’s property only for actual costs, such as transportation fees and/or meeting expenses, after being scrutinised by the court. This means that professional fees, such as attorneys’ fees, would usually be paid by the committee members and not by the debtor. The court could appoint an interim trustee or a trustee to replace the management of the debtor in rare cases where the debtor’s existing management is found to be inappropriate.

Like the RL, the CRL provides several forms of assistance to the debtor. The first set of measures is aimed at protecting the debtor’s assets in the period of time between the filing for commencement of the case under the CRL and the time of the commencement order. The court may issue one of several types of preservative injunctions and other orders, which are described in detail above. The commencement order itself provides a second set of measures to protect the debtor’s assets during the Civil Rehabilitation proceeding. Most importantly, the debtor is prohibited from making any payments on debts owed before the commencement order. All creditors must file a proof of claim to be examined and allowed before becoming eligible to receive any payments under the rehabilitation plan. Unlike the RL, however, the proceeding under the CRL does not bind secured creditors, and they may enforce their security rights without going through the Civil Rehabilitation proceeding.

The CRL also provides for a power of avoidance in order to void certain sales of the debtor’s assets made while the debtor was in a financially distressed condition. However, this power is available only to a supervisor and not to the DIP (management of the corporation). The specifics of the avoidance power are essentially the same as those under the RL.

Finally, the court may approve the assignment of all or part of the debtor’s business if it is necessary for the successful restructuring of the company. The proceeding is largely the same as that in the RL.

Like the RL, the CRL provides some protection for creditors’ rights. Administrative claims similar to those under the RL, as well as priority claims (including statutory liens and certain tax claims), are paid at any time at the discretion of the debtor. Some creditors are entitled to execute the right of set-off. These provisions are discussed in greater detail in the context of the RL.

In principle, the CRL does not bind secured creditors, and they may enforce their security rights without going through the Civil Rehabilitation proceeding. However, as an exception, upon the request of the debtor, the court may extinguish the security rights if the collateral is indispensable for the continuation of the debtor’s business and the debtor provides to the court the present value of the collateral (not the face amount of the claim). The purpose of
this exception is to allow the debtor to keep indispensable collateral (such as a factory
and/or raw materials) in order to ensure the continuation of the debtor’s business.

A rehabilitation plan may be submitted by either the debtor or the creditors. The plan must
set forth the terms amending the rights of creditors, including but not limited to, an extension
of the due dates and a haircut of the amount of the claims.

The time period for completing the distribution under the rehabilitation plan is no more than
10 years following the confirmation of the plan.

The CRL provides for a “summary rehabilitation proceeding” or a “consensual rehabilitation
proceeding” to avoid the time-consuming process of the full proceeding. A summary
rehabilitation proceeding is a “quasi-prepackaged plan”, which requires the consent of
creditors holding at least 60% of the total amount of unsecured claims at the time of filing.
This proceeding eliminates the examination of the proof of claims, the result of which is
confirmation and allowance of the filed claims. However, the proceeding requires the
acceptance of the plan at the creditors’ meeting. A consensual rehabilitation proceeding is
even quicker and simpler than a summary rehabilitation proceeding because it requires
neither the creditors’ meeting nor the examination of the claims. This proceeding, however,
requires the unanimous consent of all creditors.

Out-of-Court Work-Out

In 2001, a committee consisting of several Japanese financial institutions introduced the
Guidelines for the Out-of-Court Workout for Multi-Financial Institutions (the “Guidelines”).
The Guidelines are intended to facilitate the rehabilitation of large corporations with
significant debts to a number of banks while avoiding court-based proceedings, which may
diminish the value of the debtor as well as consume time and money. Although many
lenders are likely to be involved, the out-of-court work-out process is still tied to a traditional
Japanese “main bank” system. A corporation typically would have a strong relationship with
a single “main bank”, to which the company would turn first for loans. The main bank
traditionally took care of lending money, assigning capable persons to the borrower and
intensively monitoring the borrower. Although this system has become less prevalent, mainly
because the banks have become more sensitive about conflict issues and financial
profitability, most corporations maintain a relationship with an existing main bank or a few
major banks. Therefore, the workout process of the borrower focuses on these financial
lenders, which are called major creditors. The current definition of “major creditors” also
includes the debtor’s principal trade creditors, as well as private equity funds and debt
servicers.

In order to initiate an out-of-court work-out, the debtor corporation, together with a main
bank, must present to its major creditors financial documents explaining the reason for
financial distress as well as a debt restructuring plan (“work-out plan”). The main methods
used under the work-out plan are the restructuring of creditors’ claims against the debtor
through haircut agreements (debt forgiveness), extension of payment deadlines and
modification of payment instalments. In addition, the Guidelines call for plans to eliminate
negative net worth and net income losses within three years, to divest the interest of
controlling shareholders and to force the retirement of the management. When the debtor
and its main bank submit to the other major creditors the plan to be accepted, they issue a
notice of “standstill” to all of the major creditors in order to freeze all activity between
themselves and the debtor for up to three months from the time of submission. Unless all
creditors consent to the proposed work-out plan before the end of this period, the out-of-
court workout will terminate. If the plan is not accepted, the debtor retains the right to file a
petition to initiate court-based proceedings such as bankruptcy, CRL or RL.
The Guidelines also include provisions for tax advantages in order to facilitate the debtor’s revitalisation. The Guidelines provide that debtors evaluate the present value of assets in order to lessen their tax burden if the book value is excessive. In addition, when a creditor agrees to reduce the amount of its claims against the debtor, the debtor may set off the income from forgiveness of indebtedness against its carried forward loss so that the tax burden does not increase. Otherwise, cash that debtors could use to pay off their debts would instead be lost to pay taxes. The Guidelines include these provisions so that the Japanese tax agency can trust that the haircut agreements have been made in accordance with a formal framework and under appropriate circumstances.

Turnaround ADR

The Turnaround ADR concept was created under the Law on Special Measures for Industrial Revitalisation and Innovation. It refers to rehabilitation proceedings for businesses facing operational failure, through mutual consultations among the affected parties rather than through insolvency proceedings in court.

When the main bank directs the out-of-court workout proceedings under the Guidelines, the main bank has normally been required by the other (non-main) banks to accept a disproportionate, and not a pro rata, amount of debt forgiveness. In the past, when the “main bank” system prevailed, a corporation would have a long-term and significant relationship with a particular bank not only in terms of lending but also in terms of the holding of shares in the corporation and appointment of the corporation’s directors, etc. However, due to recent disruptions in the system, main banks no longer have a reason to assume an especially heavy obligation. Consequently, it has become more difficult to achieve consensus among financial institutions concerning the ratio of the amount of debt forgiveness under the out-of-court workout.

The Turnaround ADR is designed to overcome the shortcomings of the out-of-court work-out process and to secure the effectiveness of the out-of-court mechanism by entrusting a fair and neutral professional, instead of a main bank, with the responsibility of executing the restructuring proceeding.

The Turnaround ADR proceedings may be carried out only by ADR providers who are certified by the Minister of Justice and who have been approved and authorised by the Ministry of Economics, Trade and Industry (“METI”), which selects specialists with the requisite knowledge of business revitalisation, as defined by the Ministerial Ordinance Concerning Alternative Dispute Resolution on Business Rehabilitation. The following is an example of the proceedings practised by the Japanese Association of Turnaround Professionals (the “JATP”), which acquired the first special certification for ADR.

Preliminary Consultation Proceeding

When the JATP receives a request for business rehabilitation ADR, it assesses the overall assets and checks the revitalisation plan of the debtor to determine the eligibility of the debtor. The JATP implements the proceeding only for debtors that are genuinely in need and are likely to survive by using the proceeding.

Preparation of the Revitalisation Plan

When the JATP determines that a case has a genuine need for revitalisation and is likely to succeed, the JATP, together with the debtor, dispatches standstill notices to the debtor’s financial creditors to request that they stop individual debt collection or seizure of collateral. Following this notice, a creditors’ meeting will be arranged and the financial creditors will attend the meeting. The revitalisation plan of the debtor will be prepared and discussed at
the meeting. When the revitalisation plan is prepared, it is vital to show that the plan is economically more advantageous to creditors than legal insolvency proceedings would be.

Process after Preparation of the Revitalisation Plan

Formulation of the plan requires the unanimous consent of all the creditors at the creditors' meeting. When the revitalisation plan receives a unanimous consent, the plan is approved and the debt forgiveness is implemented on the basis of the approved plan. If the consensus of all creditors cannot be obtained and the revitalisation plan is denied, the case can be transferred to a legal insolvency proceeding, either to a specific conciliation proceeding or a statutory insolvency proceeding.

A specific conciliation proceeding is managed by the court. The proceeding is the same as the turnaround ADR in that it requires the unanimous agreement of all creditors. However, since this proceeding takes place before the court, the creditors are more likely to be encouraged to agree to the plan than under the ADR processes. Civil conciliation proceedings also contain the “decision in lieu of conciliation” mechanism, in which the court can make necessary decisions to resolve the dispute. When a decision in lieu of conciliation is made, it becomes final unless a motion of objection is filed within two weeks.

If there is no possibility of formulating a revitalisation plan under the specific conciliation proceeding (i.e. unanimous consent cannot be reached), the case can be transferred to legal insolvency proceedings, e.g. a Civil Rehabilitation proceeding or a Corporate Reorganisation proceeding.

Corporate Insolvencies

Proceedings under the Bankruptcy Law are the normal mechanism for liquidation and dissolution, and special liquidation proceedings are usually used either for corporations that are subsidiaries of a conglomerate company or for corporations whose majority creditors are amicable, even in a financially troubled situation. Alternatively, a corporation may use several out-of-court mechanisms to revitalise its business.

Court-Based Liquidation Proceedings

Bankruptcy Law

A debtor or its creditor may petition the court to initiate a proceeding under the Bankruptcy Law if the debtor is unable to make payments when debts become due or if the debtor’s liabilities exceed its assets. If either of these conditions is met, the court will issue a commencement order and appoint a trustee to manage the bankruptcy estate, which consists of all assets that belong to the debtor at the time of the commencement order. Eventually, the bankruptcy estate is liquidated into cash, which will be distributed to claim-holders in order of priority.

The bankrupt corporation may petition for a preservative injunction to protect the bankruptcy estate between the time of the filing and the issuance of the commencement order. The injunction prohibits the disposition of the debtor’s assets and the collection and payment of pre-injunction debts. The bankrupt may also petition for other forms of interim protection such as cease and desist orders, comprehensive prohibition orders, interim administration orders and injunctions in preparation for avoidance actions.

All unsecured creditors must file proofs of unsecured claims with the court, and the proofs of claims are examined by the trustee and other creditors at a claim examination hearing. All claims allowed at the claim examination hearing have the effect of a final judgment. The Bankruptcy Law requires that a first creditors’ meeting be held on the same day as the claim
examination hearing. In practice, however, the Tokyo District court typically approves the omission of this meeting. A second creditors’ meeting is usually held within three months of the commencement order so that the trustee may report the status of the debtor’s estate following the examination of claims.

Creditors’ claims are classified into several categories for repayment. Administrative expenses receive the highest priority and consist of administrative costs and expenses, certain taxes and salaries and severance pay accrued within three months prior to the commencement order. Priority bankruptcy claims receive second priority and include claims such as other unpaid salaries, bonuses and severance pay. Third priority is given to ordinary unsecured bankruptcy claims, which include trade claims and other claims without priority. Subordinated bankruptcy claims receive fourth priority and include interest, default interest and other penalties that accrue after the order of bankruptcy commencement. The lowest priority is given to contractual subordinated bankruptcy claims.

Certain types of claims receive different treatment from the order of priority stated above. First, creditors with security interests have the right to exclude their claims from the proceeding and generally will not be affected by such proceeding. Secured creditors may receive payments on the security interest and they may initiate foreclosure procedures to obtain the value of the collateral. However, the trustee may ask the court to extinguish a security interest and sell an asset free and clear from any security interest if it is in the creditors’ general interest. The purpose of this extinguishment of security interest is to sell the collateral at a value much higher than that of the secured claim so that the residual value may be included in the bankruptcy estate that is distributed to unsecured creditors. Second, the power of avoidance gives the trustee the right to avoid transactions that were made for the purpose of fraudulent conveyance or preference after the debtor fell into financial difficulty. Third, the right of set-off allows a creditor to set off a debt owed to the debtor at the time of the commencement order against a claim payable by the debtor.

**Special Liquidation Law**

A corporation may also opt for special liquidation under the reformed Companies Act. The corporation first initiates a regular liquidation proceeding by passing a resolution for the dissolution of the corporation at a shareholders’ meeting. The corporation must then appoint a liquidator (usually former management), who is responsible for giving public notice and requesting that creditors report their claims. If the liquidator finds that the corporation is insolvent (balance-sheet insolvency), he must then file a petition for special liquidation with the court. Alternatively, the court may issue a commencement order for a special liquidation proceeding if there are circumstances that would pose significant problems for the debtor’s liquidation or the corporation is in danger of balance-sheet insolvency. As with other insolvency proceedings, the court may also issue a preservative injunction to protect the debtor’s assets before the court is able to issue the commencement order.

When the court issues a commencement order, the liquidator usually becomes the special liquidator. Alternatively, it is common for the corporation to hire a qualified lawyer as special liquidator. The special liquidator is responsible for gathering the debtor’s estate and formulating a distribution plan for the distribution of the estate. Claims are treated with the same priority as in a bankruptcy proceeding but typically with more flexibility. The distribution plan should provide for the restructuring of debts, including debt forgiveness and instalment payments. If the plan is not accepted at a creditors’ meeting by a creditors holding more than half of the amount of claims, the special liquidation proceeding shifts to a bankruptcy proceeding. The special liquidation proceeding is commonly used for the dissolution of an insolvent subsidiary of a conglomerate corporation that is reorganising the companies within the group companies. The advantage for a conglomerate is favourable tax treatment in the
special liquidation of its subsidiary. Moreover, the conglomerate is not bothered by a court-appointed trustee who is unfamiliar with the corporation’s business.

Out-of-Court Mechanisms

Several other out-of-court mechanisms are available for the revitalisation of insolvent corporations. First, the use of DES is an option that has been more widely used since 2002, when relevant laws were reformed to allow banks to own more than 5% of a company’s outstanding stock. Under this mechanism, banks may convert the debt owed by the debtor corporation to equity based on the present value of the debt. Banks can enjoy the upside of the stock value if the insolvent corporation successfully revitalises itself and its value continues to rise. On the other hand, it is possible for private equity funds to minimise the risk to banks by purchasing the stock swapped from the debt.

Second, “corporate recovery” private equity funds will often target financially distressed corporations directly instead of purchasing shares from a bank. After acquiring a corporation’s loan claims and implementing the DES to become a shareholder, the private equity fund will overhaul the business so that the fund may sell the corporation privately or publicly for a profit.

Third, DIP financing is usually necessary for a financially troubled corporation to maintain business operations, especially at an early stage of corporate revitalisation. The Development Bank of Japan is the most active provider of DIP financing, and several other commercial banks and finance companies have also established DIP lending businesses. DIP financing claims are treated with equal priority to administrative expenses during subsequent statutory insolvency proceedings.

Fourth, restructuring advisory services are available to help financially distressed corporations to restructure their businesses and resolve excessive debts. Although banks formerly performed these services as part of the “main bank” system, currently independent firms provide these advisory services under more transparent procedures.

Fifth, experienced turnaround managers may be brought in to oversee the reorganisation of viable but loss-making businesses. Although the number of qualified turnaround managers is still limited in Japan, there are several cases in which Japanese companies have sought the assistance of subsidiaries of US-based turnaround firms.

The Japanese government created two corporations several years ago to revitalise the economy by removing non-performing loans and reorganising businesses. The Industry Revival Corporation (“IRC”), which was intended as a short-term endeavour and was only in existence from 2003 to 2007, used a number of the mechanisms listed above to revive struggling corporations. The Resolution and Collection Corporation (“RCC”), which was originally established to purchase sub-performing loans from financial institutions and to collect these debts, has taken over the IRC’s role. It primarily uses DES or a similar approach, such as a private equity fund, in order to revitalise companies in a sustainable way that does not require government funding.

Conclusions and Additional Observations

Japan’s insolvency laws provide corporations and individuals with numerous statutory proceedings and out-of-court mechanisms for rehabilitation and liquidation. Troubled corporations may use the RL, the CRL, the Guidelines or the Turnaround ADR to restructure their obligations to creditors, and they may use the Bankruptcy Law and the Special Liquidation chapter under the Companies Act for the dissolution and liquidation of the company. Several other mechanisms are available to revitalise financially distressed
corporations, including assistance from government-capitalised corporations, private equity funds and independent services. Heavily indebted individuals may also make use of the CRL and the Bankruptcy law, which provide a fair and reasonable way to rehabilitate or make a “fresh start”.

Moreover, Japanese insolvency law no longer suffers from territoriality. The Law on Recognition of and Assistance in Foreign Insolvency Proceedings (“LRAF”) and the Law to Amend a Portion of Civil Rehabilitation Law, etc. (“LACR”) came into force in 2001 on the basis of the UNCITRAL Model Law on Cross-Border Insolvency. The LRAF allows a foreign debtor to file a petition with a Japanese court for recognition of and assistance with a foreign insolvency proceeding. Once a recognition order has been issued, any of several assistance orders may be issued as the case may require for the protection of the foreign debtor’s assets in Japan. In addition, the LACR made changes to the CRL, the RL and the Bankruptcy Law to introduce a set of rules for cross-border insolvency.

Japan’s insolvency laws have been well adapted to the necessities of the Japanese business environment and well aligned with international standards for insolvency proceedings.

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Overview and Introduction

This Guide discusses various types of bankruptcy proceedings operating in respect of companies and provides a general overview of local corporate insolvency laws.

In addition, this Guide provides a basic overview of the Bank Restructuring Law¹ promulgated amid the international financial crisis of 2007. The Bank Restructuring Law establishes a legal framework for the restructuring of obligations of Kazakhstani banks.

In Kazakhstan, only companies and not individuals may be subject to bankruptcy proceedings. While this may change in the future, the concept of "bankruptcy of individuals" is not known in Kazakhstani law.

Applicable Legislation

The main components of the Kazakhstani insolvency and restructuring legislation include the Law “On Rehabilitation and Bankruptcy” dated 7 March 2014 (as amended, the “Bankruptcy Law”) and the Bank Restructuring Law.

Additional laws and regulations may interact with the Bankruptcy Law and the Bank Restructuring Law.

Corporate Non-Banking Insolvency

Insolvency Test

Under the Bankruptcy Law, a company may be placed under bankruptcy proceedings if a company is insolvent. Broadly, a company will be deemed to be insolvent if it is unable to pay debts within three months from the date when they fell due.

Solvency is a question of fact and thus, in assessing solvency, regard should be given both to debts that are currently due and payable and to future debts and their timeframe for payment.

Main Types of Insolvency Proceedings

The Bankruptcy Law provides for the following types of insolvency proceedings which may be applied against a Kazakhstani company: insolvency arrangement, rehabilitation, accelerated rehabilitation, bankruptcy liquidation and voluntary arrangement.

Insolvency arrangement, rehabilitation and accelerated rehabilitation are court-supervised pre-bankruptcy proceedings whereby the debtor tries to improve its financial structure.

Bankruptcy liquidation is the most common form of bankruptcy. In bankruptcy liquidation, the assets of the bankrupt entity are sold and the proceeds are distributed among the creditors according to the established priorities.

Voluntary arrangement can be entered into at any time during a bankruptcy proceeding. A voluntary (settlement) agreement is entered into between the debtor and creditors in order to terminate the bankruptcy proceeding.

Commencement of Bankruptcy Proceedings

A creditor is entitled to seek commencement of court-based bankruptcy proceedings if the amount owed by the debtor to tax authorities in connection with payment of taxes and other obligatory payments is more than 150 times the monthly calculation index\(^2\) or if the amount owed by the debtor to other creditors is more than 1,000 times the monthly calculation index.\(^3\) In addition, court-based bankruptcy proceedings may be initiated in respect to voluntary liquidation\(^4\) if the assets of the debtor being voluntarily liquidated are insufficient to satisfy all claims of the creditors. In voluntary liquidation, the liquidation commission of the company has a duty to promptly apply to court to initiate the bankruptcy proceedings.

The Bankruptcy Law does not require that an announcement be made immediately when a creditor files for bankruptcy of a debtor. Under the Bankruptcy Law, such an announcement should be made when the court commences bankruptcy proceedings against the debtor. Accordingly, it may not be possible for other creditors of a debtor to immediately know about the filing for bankruptcy.

After the bankruptcy proceedings are commenced (as applicable to both the involuntary liquidation and voluntary liquidation mentioned above), the court must hear the case on its merits and adopt one of the following decisions:

- To declare the debtor bankrupt and commence bankruptcy liquidation (a creditors’ committee will be formed at this stage to oversee the bankruptcy);
- To refuse to declare the debtor bankrupt and terminate the proceedings;
- To commence rehabilitation procedures;
- To terminate the proceedings against the debtor if the creditor has withdrawn its claim or if the debtor was rehabilitated in the course of rehabilitation proceedings; or
- To approve the voluntary (settlement) agreement and terminate bankruptcy proceedings.

The debtor will be declared bankrupt and liquidated if the debtor fails to prove its solvency, or if the debtor acknowledges its insolvency.

Implications of the Commencement of Bankruptcy Proceedings

Once the bankruptcy proceedings have commenced, a number of restrictions are placed on the company and its shareholders:

- The owner of the company’s property, its shareholders and its management bodies will not be allowed to dispose of, or otherwise transfer, the company’s assets without the approval of the temporary manager, other than in the course of ordinary business operations; and
- The company’s shareholders and the owners of the company’s property will not be allowed to sell or otherwise transfer their shares and ownership interests, respectively.

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\(^2\) Approximately USD 964.

\(^3\) Approximately USD 6,427.

\(^4\) I.e. liquidation initiated on a voluntary basis by the competent body of a debtor.
In addition, the commencement of bankruptcy proceedings will generally suspend the enforcement of unsatisfied earlier court judgments and arbitral awards, and will trigger the need for the creditors to file their claims against the company only within the bankruptcy proceedings.

Bankruptcy Liquidation

Bankruptcy liquidation is the most common form of bankruptcy, and it commences immediately following the court’s declaration of the debtor’s bankruptcy.

In bankruptcy liquidation, the court or competent authority\(^5\) (depending on circumstances) appoints an insolvency official who, among other powers, has the power to review and approve (or reject) the claims of creditors, as well as to develop (together with the creditors’ committee) a plan on the sale of the debtor’s property. The insolvency official must be an individual who passed a special qualification exam and notified the competent authority about the commencement of its activity and should be independent from the creditors and the debtor. The insolvency official is responsible for adjudicating the creditors’ claims and, in doing so, must prepare the list of creditors who may receive satisfaction from the debtor’s bankruptcy estate. The list of creditors is then sent to the competent authority for publication on its website.

In bankruptcy liquidation, the secured creditors, subject to certain statutory exemptions, are paid in priority to unsecured debts (to the extent of the value of their security). The statutory exemptions having statutory priority over secured claims include employee claims, injury compensation claims, social and pension payment claims and claims under IP contracts. The administrative and court expenses are recovered outside the established priority and thus may be reimbursed at the very first instance, even before the listed employee and other statutorily preferred claims.

In Kazakhstan, a secured creditor generally may not simply take possession of the collateral. Therefore, as a general rule, in bankruptcy liquidation secured creditors will receive only the amount of their secured claims (subject to the above-mentioned limitations); they will not receive the actual assets pledged as security. In certain cases, i.e. upon consent of creditors’ meeting, the secured creditor may receive the actual pledged asset. In these cases, the secured creditor must pay statutorily preferred claims, such as employee claims, etc. and administrative expenses incurred in connection with the maintenance of the secured asset. All unsecured debts rank pari passu, and if the property of the debtor is insufficient to meet them in full, they must be paid proportionately.

The Bankruptcy Law requires that, generally, the bankruptcy liquidation be completed within nine months. In certain cases, this period may be extended, but for not more than three additional months.

Clawback and Recovery Mechanisms

Under the Bankruptcy Law, the insolvency official has authority to investigate the affairs of the company, to identify persons liable for the bankruptcy of the company and to take actions against directors (management) or third parties to recover certain assets or to invalidate certain transactions. All these are established with the purpose of increasing the bankruptcy estate available for the distribution to the creditors.

\(^5\) State Revenue Committee of the Ministry of Finance of the Republic of Kazakhstan.
In particular, under the Bankruptcy Law, the insolvency official may request court invalidation of a transaction if it was executed:

- Within six months prior to commencement of the bankruptcy proceedings and if it prioritises the demands of certain creditors before the others;
- Within three years prior to commencement of the bankruptcy proceedings if under the transaction a counterparty received property without consideration or for consideration below market value, or if the transaction was made without sufficient grounds, and in each case the transaction adversely affected the interests of the creditors;
- Within three years prior to commencement of the bankruptcy proceedings if the value or other terms of the transaction are materially detrimental to the debtor as compared to the value and other terms of similar transactions made in comparable circumstances and if such transaction resulted in financial losses; or
- Within three years prior to commencement of bankruptcy proceedings if the transaction is an ultra vires transaction.

### Insolvency Arrangement

If the debtor is insolvent, the debtor may initiate an insolvency arrangement procedure, which is a court-supervised pre-bankruptcy procedure aimed at the restructuring of a debtor’s obligations. To initiate the procedure, the debtor must file a petition with the court and simultaneously notify its creditors.

Within two months after initiation of an insolvency arrangement, the debtor must enter into a restructuring agreement with all creditors. The agreement may provide for deferral of debt repayment, full or partial debt write-off, assignment of claims and other terms that do not contravene Kazakhstani legislation. The agreement may be entered into for a term not exceeding three years. The agreement must be approved by all creditors, and if any creditor refuses to approve the agreement, then the agreement may not be concluded.

After the agreement is approved by creditors, it must be submitted to the court for approval. From the date the court resolution approving the agreement enters into legal force, the agreement will be binding on the debtor, creditors and third parties that participate in the agreement. In addition, from the date of such court resolution (i) penalties and interest on debtor’s debts will stop accruing, (ii) any liens on the debtor’s bank accounts will be lifted, (iii) court decisions and arbitral awards may not be enforced against the debtor (with limited exceptions), and (iv) no arrests or liens may be imposed on the debtor’s assets (with limited exceptions).

### Rehabilitation

Rehabilitation may be established on the basis of a court decision at the petition of the debtor or creditor.

Rehabilitation is not a mandatory procedure, and the debtor (or creditor) can apply for rehabilitation if it is unable to pay its existing debts or its debts falling due within the next 12 months. The law appears not to establish any substantive test with respect to the amount of the unpaid debt, thus the debtor can apply for rehabilitation even if it is unable to pay a relatively insignificant debt.
During rehabilitation, the debtor must prepare a rehabilitation plan and deliver it to the creditors and thereafter to the court for approval. The rehabilitation plan must contain measures intended to restore the solvency of the debtor. Furthermore, the plan must contain a debt repayment schedule according to which the creditor claims included into the rehabilitation plan will be satisfied.

The primary purpose of rehabilitation is to give the debtor an opportunity to rehabilitate its financial structure and to restore its solvency. Thus, if the rehabilitation is successful, the debtor will emerge from bankruptcy proceedings; if not, the debtor will be subject to the bankruptcy liquidation procedure discussed above.

The rehabilitation plan must be implemented (and the relevant creditor claims included into the plan should be satisfied) within a period not exceeding five years. The competent authority will appoint a rehabilitation manager to supervise implementation of the plan. The rehabilitation manager will also take control of the company and enter into ordinary business transactions on behalf of the company. The rehabilitation manager may enter into transactions outside of the ordinary course of business only if such transactions are contemplated by the rehabilitation plan, or if the transactions are specifically approved by the creditors.

Rehabilitation must be completed within the term established by the court, which has the right (at the request of the rehabilitation manager and upon the creditors’ consent) to prolong the originally established term for an additional term not exceeding six months. After expiration of the rehabilitation term, the court may: (i) if the solvency of the subject entity was restored, issue a resolution terminating the rehabilitation proceedings; or (ii) if the solvency was not restored, issue a resolution terminating the rehabilitation proceedings and commencing bankruptcy liquidation proceedings.

The rehabilitation manager has the same clawback and recovery rights as the rights of the insolvency official discussed under “Clawback and Recovery Mechanisms” above. In addition, the rehabilitation manager may reject the performance of contracts that were made prior to the commencement of rehabilitation proceedings and that have not been fully performed by both parties in any of the following circumstances: (i) where the contract is made with the debtor’s affiliated party; (ii) where the contract contains unusually burdensome provisions or is long-term (i.e. more than one year); or (iii) where performance might adversely affect the interests of other creditors.

During the rehabilitation procedure, the same restrictions will apply with respect to the company and its shareholders as the restrictions discussed under “Implications of the Commencement of Bankruptcy Proceedings” above.

**Accelerated Rehabilitation**

Accelerated rehabilitation is a procedure applied with respect to a debtor that is unable to pay its existing debts or that will be unable to pay its future debts falling due within the next 12 months. Generally, accelerated rehabilitation is similar in many respects to the rehabilitation procedure discussed above, except that the accelerated rehabilitation is applied prior to bankruptcy liquidation or rehabilitation with a view to imposing a moratorium on the commencement of bankruptcy proceedings against the company.

Thus, upon instigation of the accelerated rehabilitation procedure, the creditors included in the rehabilitation plan will not be able to commence bankruptcy proceedings against the company.

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6 I.e. there is a rehabilitation plan approved by the creditors and court, and claims of creditors included in the plan are satisfied in accordance with the debt repayment schedule contained in the plan.
The accelerated rehabilitation procedure must be completed within two years; however, at the request of the company and upon the creditors’ consent, the court has the right to extend this two-year period for an additional period not exceeding six months. Unlike the rehabilitation procedure, during accelerated rehabilitation the company’s management will remain in place and the competent authority will not appoint a rehabilitation manager.

**Voluntary Arrangement**

Voluntary arrangement may be entered into at any time during a bankruptcy proceeding. A voluntary (settlement) agreement is entered into between the debtor and creditors in order to terminate the bankruptcy proceeding.

The voluntary (settlement) agreement covers all registered creditors, except certain statutorily preferred creditors (e.g., employees). It provides the terms and procedure for repayment of creditors’ claims.

An agreement must be approved by a simple majority of creditors and the court. After an agreement is approved, bankruptcy proceedings with respect to the debtor will terminate and the debtor must repay creditors’ claims in accordance with the agreement. An approved agreement is binding on all creditors, including the creditors who voted against it or did not vote.

An agreement may be terminated upon the request of a creditor (creditors) holding at least 25% of registered claims by value if the debtor (or third parties participating in the agreement) fail to perform their obligations with respect to such creditors. In that case, the agreement will be terminated and bankruptcy proceedings will be re-initiated against the debtor.

**Bank-specific Insolvency Proceedings**

There are certain special insolvency-related proceedings that apply to Kazakhstani banks that operate outside of the formal insolvency provisions of Kazakhstani legislation. These special proceedings are discussed below.

In Kazakhstan, the competent authority for banks is the National Bank of Kazakhstan (the “National Bank”), the country’s central bank. Generally, the National Bank oversees all second-tier banks, including matters related to their solvency and liquidation (as discussed below), and establishes certain prudential, liquidity and other requirements mandatory for all such banks.

**Conservation**

The National Bank, Kazakhstan’s bank regulatory body, is authorised to implement bankruptcy prevention measures in respect of a bank (“conservation”, or konervatsia) with or without the establishment of a stabilisation bank (discussed below). The National Bank may also order temporary administration of a bank (vremennaya administratsiya).

If a Kazakhstani bank has financial difficulties or does not comply with certain capital adequacy requirements, the National Bank may put the bank into conservation for up to one year with the goal of improving the bank’s financial position and the quality of its operations, and also with the goal of preventing the bankruptcy of the bank. Conservation is supervised by the National Bank. The National Bank appoints a temporary administration, which takes control of the bank. The temporary administration has the right to suspend any of the bank’s payment obligations under deposit agreements and to terminate or unilaterally amend the bank’s contracts which provide for investing (depositing, putting in, etc.) of the bank’s money.
Conservation does not involve an automatic stay. The bank’s creditors have the right to bring court actions against the bank and seek enforcement of court judgments during conservation. But again, the administrator can suspend the payments (under deposit agreements) by the bank, until the end of the conservation. If conservation is successful, the National Bank will terminate it (or, at the end of the period of conservation, the conservation will automatically terminate) and the bank will resume its business as usual. If conservation is unsuccessful, the National Bank is likely to force the bank into liquidation. The authors are not aware of any successful conservation in Kazakhstan; all banks, insurance companies and pension funds which thus far have undergone conservation were eventually liquidated.

**Debt Restructuring**

A bank can apply for restructuring if it is unable to repay its debt to one or more creditors within seven days after the debt became due, where such inability is caused by a lack of funds. The law does not establish any monetary threshold for this right. The bank’s decision to seek restructuring effectively should be approved by the National Bank.

Further, the bank should prepare a restructuring plan, have it approved by the National Bank and then apply to a court seeking an order on restructuring. Generally, the order on restructuring suspends enforcement of court judgments or arbitral awards in relation to obligations which are to be restructured and lifts any liens over the bank’s assets.

The bank must then seek approval of the restructuring plan from creditors holding not less than two-thirds of the total amount of the debt to be restructured. After two-thirds of the creditors approve the restructuring plan, it must be submitted to the National Bank and, if the National Bank does not have any comments, to the court for approval.

The restructuring plan approved by the creditors and by the court will be binding on all the creditors whose debts are included in the restructuring plan, whether or not a particular creditor approved the plan. Upon implementation of measures provided in the restructuring plan, the court will terminate restructuring proceedings, at the request of the National Bank. Obligations of the bank included in the restructuring plan will be deemed to have been performed, and enforcement of any court judgments and arbitral awards in respect of such obligations will be terminated.

Bank debt restructuring may be recognised as main insolvency proceedings in countries which have adopted the UNCITRAL Cross-Border Insolvency Law, thus giving protection against dissenting creditors’ claims in such countries. This happened in the 2009 and 2012 BTA Bank restructurings, where the Kazakhstani debt restructuring procedure was recognised in the US and UK.

**Stabilisation Bank**

After the National Bank puts a bank into conservation (or revokes a bank’s licence), it may require that all or part of the bank’s assets and liabilities be transferred to a stabilisation bank established specifically for such purposes. A stabilisation bank is a special-purpose vehicle, wholly owned by the National Bank, for acquiring assets and liabilities of a financially troubled bank. The stabilisation bank is not required to comply with capital adequacy, reserve capital, management, or most other requirements generally applicable to banks. It is also not subject to corporate law provisions on corporate governance, voting, authority of the bank’s bodies, related-party transactions and major transactions.

The law does not require consent of any of the bank’s creditors to transfer the bank’s assets to the stabilisation bank. The National Bank can effectively cherry-pick valuable assets and transfer them to the stabilisation bank, while non-performing assets will be left with the bank.
The stabilisation bank will enjoy a 12-month standstill in respect of the most of its debts (except debts to government, secured debts to other banks, term deposits and certain other obligations).

The regulator exits the stabilisation bank through a share or asset sale once a qualified investor is found.
Overview and Introduction

Malaysia has a federal system of laws governing insolvency, with a separate legislative scheme for companies (winding-up) and individuals (bankruptcy). The Malaysian insolvency system is similar to and based on the English model.

Applicable Legislation

At the time of this writing, the legislation governing bankruptcy consists of the Bankruptcy Act 1967 (the "Bankruptcy Act") and the Bankruptcy Rules 1969, while the legislation governing winding-up consists of the Companies Act 1965 (the "Companies Act"), the Companies Regulations 1966 and the Companies (Winding-Up) Rules 1972. However, the new Companies Bill 2015 would substantially reform the current insolvency and corporate restructuring laws found in this guide. The bill was passed by Parliament in April 2016 and is expected to come into force in due course. The Companies Act and its subsidiary legislation are still in force at the time of writing.

Personal Bankruptcy

One manner in which a creditor can recover his debts against an individual is to obtain a judgment and execute it against the debtor by commencing bankruptcy proceedings. The primary effect of bankruptcy in Malaysia is to vest all the debtor's property and assets in the Director-General of Insolvency for liquidation and distribution amongst the debtor's creditors. Bankruptcy proceedings remain a popular mode of recovery of a debt from an individual. In addition, bankruptcy proceedings can also be invoked by the debtor himself to declare his inability to meet his creditors' claims.

Conditions of Bankruptcy Proceedings

The jurisdiction to adjudicate on bankruptcy matters is vested in the High Court. Before a creditor may commence bankruptcy proceedings against a debtor, it is a precondition that the amount owing by the debtor is MYR 30,000 or more.

Apart from the statutory requirement of a debt of at least MYR 30,000, a debtor must also have committed an act of bankruptcy as prescribed under the Bankruptcy Act. Among the common acts of bankruptcy are the debtor's failure to comply with a bankruptcy notice, making a fraudulent conveyance to transfer his property, absconding with the intention to defeat or delay his creditors and giving notice of suspension of payment to his creditors.

The act of bankruptcy must have been committed by a debtor. Under the Bankruptcy Act, the debtor is deemed to include any person who at the time when the act of bankruptcy was carried out:

(a) Was personally present in Malaysia;
(b) Ordinarily resided or had a place of residence in Malaysia;
(c) Was carrying on business in Malaysia either personally or by means of an agent; or
(d) Was a member of a firm or partnership which carried on business in Malaysia.
Commencement of Bankruptcy Proceedings

Upon fulfilment of the preconditions and once a monetary judgment has been obtained, the creditor may commence bankruptcy proceedings by issuing a bankruptcy notice founded on such judgment and serve the same on the debtor. Bankruptcy proceedings are said to have commenced on the issuance of a bankruptcy notice. The bankruptcy notice acts as a demand for the debtor to pay his debts.

Bankruptcy Petition

If the debtor fails to comply with the bankruptcy notice within seven days of its service on the debtor, a petition may be presented, either by a creditor or several creditors, in the High Court in the state where the debtor resides. The petition will then be heard. The creditor is required to attend the hearing.

A debtor may show cause against a creditor’s petition by filing a notice with the Registrar of the High Court, specifying the statements in the petition which he intends to deny or dispute and subsequently serving the notice on the petitioning creditor and his solicitor, if known.

Receiving Order and Adjudication Order

Once the debt of the petitioning creditor, act of bankruptcy and service of petition are proved to the satisfaction of the court, it will proceed to make a receiving order.

The court may simultaneously adjudge the debtor a bankrupt through an adjudication order, unless the debtor can show to the satisfaction of the court that he is in a position to offer a composition or make a scheme of arrangement satisfactory to his creditors.

The receiving order will enable the Director-General of Insolvency to take possession, custody or control of the debtor’s property, as the receiver of such property. The receiving order in itself does not make the debtor a bankrupt, nor does it deprive the debtor of ownership or proprietary rights over his property. He is deprived of control and possession only.

Once the adjudication order has been made, the property will be vested in the Director-General of Insolvency and becomes divisible among his creditors.

Effects of Bankruptcy

Where an adjudication order is made, the Director-General of Insolvency takes control of the bankrupt’s personal affairs, property, and the administration of his estate, subject to equities and encumbrances thereon. The bankrupt’s personal liberty is then controlled by the Director-General of Insolvency and he is subject to the latter’s directions.

Corporate Restructuring and Insolvency

Reorganisations, Restructurings and Work-Outs

Before the process of insolvency, there are several methods of company reorganisations, restructurings and work-outs. Generally, company restructuring and reorganisations are governed by the Companies Act 1965. An application to the court may be made under sections 176 and 178 of the Companies Act for the approval of a scheme of arrangement for companies undergoing reorganisation and restructuring.
Insolvency (Winding-Up)

In the winding-up process of a company, the company’s business is closed, its assets sold off, the creditors paid, the balance distributed to its members and eventually the company ceases to exist. In Malaysia, a company may be wound up voluntarily or compulsorily by an order of court.

Court-Based Insolvency

The most common ground in support of a winding-up by the court is the inability of a company to pay its debts.

A company shall be deemed to be unable to pay its debts if:

(a) A creditor of the company has served a statutory notice on the company for a debt exceeding MYR 500 at its registered office, requiring the company to pay the sum so due, and the company thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor within three weeks;

(b) Execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part; or

(c) It is proved to the satisfaction of the court that the company is unable to pay its debts; and in determining whether a company is unable to pay its debts the court shall take into account the contingent and prospective liabilities of the company.

Pre-Court Procedures

The simplest method of establishing a company’s inability to pay its debt is through the issuance of a statutory notice to the company, demanding that the debt be paid within three weeks. The demand must relate to a specified liquidated sum that cannot be seriously disputed by the debtor. Failure by the debtor company to pay the sum demanded within three weeks raises a rebuttable presumption that the company cannot pay its debt, entitling the creditor to proceed with a petition to wind up the debtor company.

Court Procedures

A compulsory winding-up is initiated by presenting a petition to be heard by the judge in open court. The petitioner must be a person to whom the debtor owes money and/or is listed under the Companies Act.

After presenting the petition to the court, the petition will be advertised. The petition must be advertised once in the Gazette and at least twice in any two local newspapers in Malaysia. The petition must be served on the debtor company as well as on the Registrar of Companies.

Hearing

At the hearing, the petitioner and the company are required to attend the proceedings. Every other person who intends to appear on the hearing of a petition shall serve on the petitioner or his solicitor a notice of his intention to appear. This includes persons who may oppose or support the winding-up petition. The judge will proceed to decide whether to allow or dismiss the petition after hearing submissions in support or opposition, if any.

Once the court makes a winding-up order, the company is deemed to have been wound up at the time the petition is presented. Once the winding-up order is made, the only way to
stop the winding-up process is by obtaining a stay of the winding-up or by appealing against the decision to grant the order.

The sealed winding-up order must be served on the wound-up company’s secretary, and lodged with the Registrar of Companies. The sealed winding-up order is also advertised in two local newspapers and is published in the Federal Government Gazette.

**Recovering Debts after a Winding-up Order**

When filing the petition the petitioner shall nominate in writing an approved liquidator, who is entitled to be appointed as liquidator if an order for the winding-up of the company is made by the court. If no approved liquidator is nominated by the petitioner, the court shall, on making the winding-up order, appoint an approved liquidator or the Official Receiver as the liquidator as it deems fit.

The liquidator then takes into his custody and control all properties and choses in action to which the company is entitled. After the entry of a winding-up order, only the liquidator has the power to dispose of, or authorise the alienation of, the company’s property.

When a winding-up order is made, the directors of the company remain in office but their powers are removed. While the company is in the process of being wound up a person cannot perform or exercise, and must not purport to perform or exercise, a function or power as an officer (other than a liquidator) of the company, except with the approval of the liquidator or the court.

**Distribution of Payments**

The priority of payment in an insolvency proceeding (winding-up) is as follows:

- Secured creditors, to the extent of the value of their collateral;
- Claims by certain third parties in respect of which the company is insured and in respect of which an amount is or has been received by the company;
- Preferential creditors, including certain claims in respect of employment by the company, the costs incurred by the petitioner and the liquidator’s costs and expenses;
- Unsecured creditors; and
- Deferred creditors.

**Out-of-Court Mechanisms**

**Voluntary Winding-Up**

A voluntary, non-judicial winding-up may be done in two ways, i.e. members’ voluntary winding-up or creditors’ voluntary winding-up. In a member’s voluntary winding-up, a declaration of solvency must be made by the directors of the company. The declaration is made to the effect that the directors of the company have formed the opinion that the company will be able to pay its debts in full within 12 months after commencement of winding-up. A special resolution for winding-up is required and winding-up is taken to have commenced upon the passing of this resolution. If a declaration of solvency is not made, the winding-up proceeds as a creditors’ voluntary winding-up.
In a creditors’ voluntary winding-up, the directors of the company will make a statutory declaration that the company cannot, by reason of its liabilities, continue its business. The directors will therefore appoint a provisional liquidator. The creditors are then summoned to a meeting with the members within one month of making the declaration. At the meeting of the creditors, a special resolution for voluntary winding-up is passed and a qualified person is nominated to be the liquidator.

Effects of Winding-Up

The main implication of winding-up is that the company would cease to carry out its business, except so far as, in the opinion of the liquidator, is required to ensure a beneficial winding-up. However, the corporate personality of the company remains and ownership of the company is not transferred to the liquidator. The liquidator merely functions to carry on the company’s business for the purposes of winding-up.

In a compulsory winding-up, the liquidator assumes the duties/powers of its board. However, in a voluntary winding-up, the directors may retain their powers, subject to the liquidator’s consent.

Dissolution of a Company

In a compulsory winding-up, after completing his duties, the liquidator may apply with the court for an order that he be released and the company dissolved. The company is dissolved from the date of the order of dissolution.

In a voluntary winding-up, the liquidator must generate an account showing how the winding-up was conducted. A final meeting of the members and creditors is called for the purpose of presenting this account. Within seven days of holding the final meeting, the liquidator must lodge a return to the Registrar of Companies and the Official Receiver. Three months after the lodging of the return, the company will be dissolved.

Additional Observations

Antecedent Transactions

Any transfer, mortgage, delivery, payment, execution or other act that, had it been done by an individual and would in his bankruptcy under the law of bankruptcy be void or voidable, shall be void or voidable in the same manner in the course of the winding-up of a company. Similarly, any transfer or assignment by a company of all its property to trustees for the benefit of all its creditors shall be void.

In the case of sale and purchase transactions between the corporate debtor and a director or company connected to a director, within a period of two years before the commencement of winding-up, the liquidator can recover from that person or company an amount that corresponds to the difference in value between the value of the asset sold or purchased and the actual consideration paid or received. The liquidator of a company may also claim the amount overpaid by the company in such circumstances. In essence, related third parties who have short-changed the company may be made accountable.

Where a creditor has issued execution proceedings against the goods or land of a company or has attached any debt due to the company and the company is subsequently wound up, the creditor will not be entitled to retain the benefit of the execution or attachment as against the liquidator of the company, unless the creditor has completed the execution or attachment before the onset of insolvency.
The Companies Act also provides that any floating charge over a company’s undertaking or property created within six months of the onset of insolvency is invalid, unless it can be shown that the company was solvent immediately after granting the charge.

Transactions during Insolvency

Any disposition of the company's property after the commencement of winding-up is void unless the court orders otherwise, in which case the creditor would have to return the property and prove its claim in the liquidation as an ordinary unsecured creditor. The court may, however, validate the transaction subject to the principle of pari passu distribution. In other words, a court will not validate transfers of assets if the effect is to give an undue preference to some creditors or to allow some creditors to be paid in full at the expense of the rest.

Any attachment, sequestration, distress or execution put in force against the estate or effects of a company being wound up by court, after the onset of insolvency, is void.

Conclusion

Winding-up proceedings are a useful, tactical way for the recovery of monies owed in circumstances where there is a clearly documented (ideally with admission) and undisputed debt, or where the debtor is a going concern with continuing trading interests, as a petition to wind up a company entails notification to financial institutions and customers by way of advertisement that the company is in an insolvent state.

Like winding-up proceedings for companies, bankruptcy proceedings remain a popular mode to seek enforcement of a judgment debt against individuals. In practical terms, however, bankruptcy proceedings in the case of individual debtors are not recommended as an effective means for debt collection unless the individual has substantial personal means. This is because the liquidation process in the hands of the Director-General of Insolvency takes many years, and it is uncommon for any actual distribution of dividends to occur. The bankrupt is usually able to secure a discharge of the bankruptcy order after five years.

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Mexico

Overview and Introduction

The Mexican insolvency and bankruptcy law (Ley de Concursos Mercantiles or the "LCM") regulates the sole insolvency procedure available under Mexican law: the Concurso Mercantil. The LCM came into effect on 12 May 2000, and abrogated the Mexican Bankruptcy and Suspension of Payments Law (the "BSPL"), which had been in effect since 20 April 1943. The LCM has undergone several reforms and adjustments to respond the realities of more sophisticated debt structures. The latest reform came into force in May 2014.

Main Aspects of the LCM

Principles

The law is based upon certain general principles:

- All holders of debts within the same classification are treated equally, without regard to nationality, domicile or capacity;
- All creditors, whether domestic or foreign, have access to the commercial insolvency proceeding and shall collect from the assets in the same proportion as other creditors in the same class;
- The debtor’s operations should be preserved when possible, and in spite of generalised non-payment of its debts, for the benefit of the country’s economy, thereby avoiding "chain bankruptcies" of the companies with which the debtor has business relations;
- The debtor’s assets and liabilities are consolidated. Third-party owners are permitted to recover assets that are in the debtor’s possession. Through these and other means, assets not belonging to the insolvent company are identified and removed from the bankruptcy estate, which will later be sold;
- Suspicious operations can be challenged and annulled if they aggravate the financial status of the debtor; and
- The LCM recognises pre-negotiated plans of restructure.

Public Interest and the Preservation of the Company

As mentioned above, the LCM maintains the fundamental principles of the field, namely, public interest and the preservation of the company. This last aspect was almost not included in the LCM because, in the project presented for the constitutional effects by the Senate to the lower chamber of Congress, on 7 December 1999, Article 1 established only that the law would be of public interest and that its purpose would be to regulate insolvency proceedings. However, when published in the Official Gazette in May 2000, Article 1 was modified to include the fundamental principle establishing that it is in the public interest to preserve companies and avoid the damaging effects of company failures on others dealing with the relevant debtor.

Jurisdiction of the Federal District Judges

The LCM provides that the competent authority to hear insolvency and commercial bankruptcy cases is the Federal District Judge with jurisdiction in the debtor's domicile. This
means that local or state judges have no jurisdiction to handle and resolve these proceedings.

In November 1999, a Senate report justified the competence of the federal judges, arguing that the insolvency or bankruptcy of a debtor constitutes an economic phenomenon which, because of its universal nature, interests the State predominantly. This argument is supported by international doctrine, which considers it to in the public interest to ensure the viability and preservation of companies, given that they provide a source of employment and support the national economy.

It is worth noting that Article 21 of the LCM establishes that in a commercial procedure, where a court (local or federal) determines that a debtor is in one of the categories of general default on the payment of obligations, the court will make this situation known to tax authorities and to the district attorney, so that, if applicable, the district attorney may request the declaration of insolvency before a federal court.

Finally, it is important to point out that Article 7 of the LCM establishes that judges ought to fulfil their obligations within the time limits established in this law. The commendable purpose of this provision is to ensure the swift administration of justice, establishing that the lack of compliance with the statutory time periods are the court's responsibility. It is also important for the preservation of the company as a main principle of the LCM.

Therefore, since the LCM came into effect, federal judges have tried to fulfil their obligations within the time limits established under this law. Nevertheless, due to the workload of the courts, time limits are not always observed.

Stages of Insolvency Procedure

Under the LCM there are two stages of the insolvency procedure: conciliation and liquidation. The purpose of conciliation is to preserve the company by means of an agreement between the debtor and his recognised creditors. The conciliation has a duration of 185 calendar days, and the term can be extended if the recognised creditors request it. In no case can the term be extended for more than one year. By virtue of an amendment dated 10 January 2014, the LCM expressly prohibits the judge from extending the conciliation stage for more than one year and from extending any other term established in the law, except in those cases where the LCM expressly authorises the judge to extend a term.

Under the LCM the debtor and creditors must attempt to reach an agreement. The negotiations are directed by a professional conciliator, who initially acts as an intermediary between the company and its creditors. According to the purposes (exposición de motivos) of the law, the conciliator acts as an amicable intermediary between the parties. Here, the law seems to strongly return to the broad horizon of alternative commercial dispute resolution.

One of the important functions of the conciliator is to recognise creditors based on the company's accounting records as well as the proof of claim filed by the creditors. The conciliator reviews the ordinary operation of the company, and he files a report with the court regarding such review. Nevertheless, the conciliator can request the court to remove the debtor from the management of the company to protect the interests of the creditors.

If the debtor is removed from the management of the company, it will be managed by the conciliator. The debtor is obliged to provide the conciliator with all the information he may need regarding the management of the company, assets, debts, workers, payments, etc.

If the conciliatory stage does not result in an agreement, the bankruptcy stage begins, and a trustee in bankruptcy replaces the conciliator as the authority for that stage. Note that the
trustee in bankruptcy can be the same individual that performed the function of conciliator, or someone else. The trustee in bankruptcy will prepare balance sheets and determinations regarding the status of the company and find the best way to pay creditors.

The purpose of the bankruptcy stage is to sell the company’s working unit, and if this is not possible, its productive units or assets that form the company, in order to pay the creditors.

The declaration of bankruptcy occurs in four circumstances:

- When the debtor himself requests it;
- When the conciliator requests it and the court agrees in light of the lack of disposition on the part of the debtor or his creditors to come to an agreement;
- When the term for the conciliation stage and its extension periods have expired and no agreement has been reached; and
- Based on an amendment dated 10 January 2014, when the creditors request it and the debtor expressly accepts the creditors’ request.

The judgment declaring the bankruptcy has the following effects, among others:

- The suspension of the capacity of the debtor to take actions over the property and rights that form the bankruptcy estate;
- The order to the debtor, his administrators, managers and employees to turn over to the trustee in bankruptcy the possession and administration of the property and rights that form the bankruptcy estate;
- The order to the debtors of the bankrupt debtor not to make payments without the authorisation of the trustee, with the notice that they will make payment twice in the case of non-compliance; and
- The order to the Federal Institute of Business Reorganisation Specialists (the “Institute”) to appoint the conciliator or someone else as trustee in bankruptcy, for the operation of the debtor’s company.

The trustee in bankruptcy delivers to the court a report on the debtor’s accounting; an inventory of the company; and a balance sheet of the administration of the company. The Institute will establish the specific formats for these reports.

Every two months, both the conciliator and the trustee must prepare a report for the court detailing, respectively, the progress of the conciliation and the liquidation of the company. This report must be available to all parties. Also, they have to file a final report of their activities.

The LCM provides that any creditor or group of creditors that represents at least 10% of debtor’s obligations have the right to request that the court designate an intervener to oversee the administration of the company, in particular the performance of the conciliator, the trustee in bankruptcy and the debtor.

Procedure for the Declaration of Insolvency

The declaration of insolvency procedure begins with the filing of the claim, either in writing or electronically, by the debtor itself, any creditor, the district attorney, and even tax authorities in their capacity as creditors.
The claimant has to cover visitor’s fees; otherwise the case will be dismissed.

Once the claim has been filed, the judge appoints a visitor in order to verify that the debtor is in general non-payment of its debts. The visitor will verify technically and physically, based on what we consider to be objective criteria, whether the debtor can be legally considered to be in insolvency.

The court declares the insolvency (or dismisses the case) based on the report made by the visitor, and only if the debtor has generally defaulted on the payment of its obligations: under Article 10 of the LCM this consists of a default on obligations that are owed to two or more different creditors, that have been due for at least 30 days and that represent at least 35% of all obligations owed by the debtor on the date on which the claim or request for insolvency is made. General default on payment of obligations also exists when the debtor does not have assets to pay at least 80% of its obligations due on the date of the filing of the petition. Article 10 defines which assets are taken into account (cash in register, sight deposits, term investments, etc.).

Article 11 of the LCM establishes the circumstances where there exists a presumption that a debtor has incurred a general default of his payment obligations. Those circumstances are:

- There is a lack or insufficiency of assets to carry out an attachment;
- The debtor fails to pay its debts to two or more different creditors;
- The debtor is missing or hiding, leaving no one in charge of the business so as to comply with pending obligations;
- The closing of the company’s business offices, leaving no one in charge of the business so as to comply with pending obligations;
- The debtor carries out fraudulent or fictitious practices so as not to pay its debts;
- The debtor breaches a settlement reached with its creditors under the law; and
- Any other analogous causes.

Also, based on the amendment dated 10 January 2014, Article 20bis establishes that the debtor itself or any creditor may request a declaration of insolvency when any of the circumstances specified in Articles 10 or 11 of the LCM, related to default on the payment of obligations, will inevitably occur within 90 days following the insolvency petition.

Article 16 establishes that branches of foreign companies can be declared in insolvency.

The court’s resolution that declares the insolvency must establish that the debtor is in general default on the payment of its obligations. It also must include a provisional list of the creditors that have been identified in the debtor’s accounting records, indicating the amount owed to each one. This list does not exhaust the procedure for the acknowledgement, ranking and determination of the priority of creditors’ claims.

Also, according to Article 43 of the LCM, the court’s resolution will include a clawback period of 270 calendar days prior to the date of declaration of insolvency (declaración de concurso); a declaration that the stage of conciliation has commenced; instructions to the Institute to appoint a conciliator; an order to the debtor to immediately make available to the conciliator the books, records and all other documents pertaining to the company, to allow the conciliator and the interveners to perform the activities necessary to accomplish their duties, and to suspend the payment of debts. It will also include, inter alia, an order to record the
court resolution with the Public Registry of Commerce within the domicile of the debtor, and to publish an extract of the same in the Official Gazette and in the newspaper with the largest circulation in the domicile of the procedure; the order to the conciliator to begin the procedure of acknowledgement of creditors; and the notice to the creditors that they may request the recognition of their claims, among others.

Interim Measures

The LCM puts in place (e.g. under Article 37) the opportunity to adopt interim measures to avoid risking the viability and preservation of the company, and thus to protect the public interest as well as the interests of creditors. These measures include separating the debtor from the operation of the company and prohibiting him from paying debts and transferring or encumbering the property of the company; the attachment of certain property; the appointment of a conservator for the merchant’s cash on hand; and an order to restrict the debtor’s freedom of movement.

The interim measures include the possibility for the debtor to obtain judicial approval to take out loans that are essential to maintain the business and/or to have liquid funds. Any loans that are approved will enjoy a preferential payment status.

Effects of the Resolution of Insolvency

The court’s resolution limits the freedom of movement of the debtor to his place of domicile¹, and in the case of a business entity, limits the freedom of the persons responsible for its administration. In this stage of conciliation, the debtor may continue operating the company, although the conciliator may request that the court remove the debtor and that the conciliator assume responsibility for managing the company. Such limitation will not be in effect in cases in which the debtor claims its insolvency.

One interesting effect of the insolvency proceeding under Article 84 of the LCM is that the claims, trials and procedures against the debtor that are in progress when the declaration of insolvency is made will not be joined under the insolvency procedure. Rather, they will continue to be pursued by the debtor under the supervision of the conciliator. Also, other claims related to the assets of the debtor might be filed by creditors with the competent authorities. Those procedures will not be joined under the insolvency procedure.

Article 65 of the LCM provides that from the moment the declaration of insolvency is made, and until the conciliation stage is over, no attachment or execution against the rights and property of the debtor can take place, except for labour claims. Also, under the amendment dated 10 January 2014, creditors with in rem guarantees have the right to continue execution proceedings against the assets they received as guarantee, once the judge declares that those assets are not essential for the ordinary business of the debtor.

Separation of Property

Chapter II of Title III of the LCM adopts from the BSPL the principle that allows the rightful owners of property in the possession of the debtor to recover said property: “The property in the possession of the debtor that is identifiable, and that has not been transferred to him by legal title that is definitive and irrevocable, may be separated by its rightful owners.” Interestingly, under the LCM, property that can be separated from the bankruptcy estate includes withheld contributions, collected or transferred by the debtor on account of the tax authorities.²

¹ Article 47 of the LCM.
² Article 71. Any property in the following situation or any other analogous events, may be set aside from the Estate:
Acts that Defraud Creditors

According to Article 113 of the LCM, acts that defraud creditors are not valid.

The LCM considers as acts that defraud creditors those made by the debtor before the declaration of the insolvency proceeding was issued and during the retroactive period (outlined below), with the aim of defrauding creditors, as long as the third party that participated in the transaction knew about the fraud.

It is not required that third parties were aware of the fraud in relation to gratuitous acts or liberalities.

According to Article 112 of the LCM, a retroactive period of 270 calendar days prior to the date on which the declaration of insolvency proceeding was issued is applicable when determining acts that defraud creditors. Under the amendment dated 10 January 2014, this period will be doubled when the debtor has subordinated creditors.3

The clawback period can be extended at the request of the conciliator, the interveners or any creditor, but any request must be filed prior to the issuance of the judgment recognising, ranking and determining the preference of claims. The request to extend the retroactive period shall be processed through ancillary proceedings, in which the plaintiffs explain and prove those acts that are considered fraudulent as to creditors. The extension will never exceed a three-year period in accordance with the amendment dated 10 January 2014.

Under the LCM the following acts within the retroactive period are considered fraudulent as to creditors:

- Gratuitous acts or liberalities;
- Acts or transfers made by the debtor with a gross undervalue;
- Transactions entered into by the debtor with terms and conditions that significantly deviate from regular market conditions or from commercial practices;
- Debt forgiveness granted by the debtor;
- Payment by the debtor of obligations not yet due; and
- Discounts granted by the debtor.

The declaration of invalidity of these acts is not effective if the resources generated are used in favour of the insolvency proceeding.

Except when the interested party demonstrates good faith, it is assumed that the following are acts of fraud involving creditors:

- Granting of guarantees or the increase of the existing ones, when the original obligation did not contemplate them; and

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3 Subordinated creditors are specified in Articles 222, section II, 117 and 15 of the LCM. Generally speaking, they are creditors without in rem guarantees who are closely related to the debtor. See “Ranking of Claims” below.
Payments in kind when the original obligation did not contemplate them or originally a monetary consideration was specified in the relevant contract.

For debtors that are companies, it is assumed that the following acts, if taken within the retroactive period, defraud creditors:

- Acts that were entered into with its sole manager or board of managers, or with their respective spouses or concubines, or with blood relatives to the fourth-degree, or relatives with no blood relationship to the second-degree, including kinship resulting from adoption;

- Acts that were entered into with individuals that jointly and severally represent, directly or indirectly, at least 51% of the subscribed-for and paid-in capital of the debtor under insolvency proceedings; individuals that have decision-making powers in the partners’ meetings; individuals that are able to appoint the majority of the members of the board of managers, or are by any other means empowered to take key decisions regarding the debtor under insolvency proceedings;

- Acts entered into with companies that have the same administrators, members of the board of managers or principal officers as the debtor; and

- Acts entered into with companies controlled by the debtor, companies that control the debtor, or companies that are controlled by the same company that controls the debtor.

The bad faith acquirer shall be liable for damages when the acquired assets were further transferred to a good faith acquirer or were lost. Likewise, the acquirer in bad faith that destroyed or hid the goods to avoid invalidity of the transaction is liable for damages.

Ranking of Claims

Before entering into the conciliation stage, under Article 121 of the LCM, the conciliator must present to the court a provisional list of claims owed by the debtor, in a format decreed by the Institute.

Under the LCM the creditors are classified as follows:

- Creditors with claims against the Estate that will be paid before any other claims. These include liabilities: (i) for wages for the two years preceding the debtor’s insolvency declaration; (ii) incurred by the debtor to manage the Estate; (iii) incurred to attend to the regular expenses for the protection of the properties of the Estate, their repair, preservation and management; and (iv) resulting from judicial or extrajudicial proceedings in benefit of the Estate.

- Uniquely privileged creditors that only exist in the event of the insolvency of an individual debtor who has passed away (funeral expenses of the debtor and expenses associated with the illness that has caused the death of the debtor);

- Creditors with in rem guarantees (security interests), who would be paid first with the proceeds from the sale of the mortgaged or pledged items;

- Creditors with special privilege, i.e. all those that, according to the law, have a special privilege or a right of withholding. For example, the builder of any movable work is entitled to withhold it until it is paid, and its claim will be preferably paid with the price of such asset;
• Common creditors or unsecured creditors whose claims will be paid pro-rata regardless of the dates of their claims; and

• After the amendment dated 10 January 2014, subordinated creditors, i.e. creditors which agreed to the subordination of their claims to the common creditors, and creditors which are: (i) controlled companies; (ii) the manager of the debtor or members of its Board of Directors, or their relatives; (iii) legal entities whose managers, members of the Board of Directors or senior officers are the same as those of the debtor; or (iv) legal entities controlled by the debtor and which have the control of the debtor, or which are controlled by the same company that controls the debtor.

The law further states that all tax and labour claims are to be paid after payment of the secured creditors, but before creditors with special privilege. The law sets forth one exception, whereby the salaries owed to employees for the past two years are to be paid before any other claim, including those of secured creditors.

Creditors must object to the provisional list of claims within five days. Then, the conciliator will have 10 days within which to file the definitive list of claims owed by the debtor, in a format decided by the Institute.

All creditors must submit a proof of claim for the recognition and classification of their claims. Article 122 of the LCM sets forth the exact time at which this can be done. Once all proofs of claim have been submitted and analysed, the court issues a judgment through which it will divide the claims into three groups: recognised claims; excluded claims; and claims pending classification.

Another important contribution made by the LCM is that the conciliatory stage has a duration of 185 calendar days, starting on the day on which the last notice of the declaration of insolvency was made in the Federal Official Gazette. This term can be extended if the recognised creditors request it, but in no case can the term be extended for more than one year. During the conciliatory stage, all executions and payments are suspended, except for those expressly authorised by the LCM. This time limit was established to prevent possible abuses of the conciliatory stage whose conclusion automatically initiates the bankruptcy.

Protection of the Real Value of the Claims

In order to protect the real value of the claims during the conciliatory stage, Article 89 of the LCM provides for the conversion of claims in both national and foreign currency, into units of investment (unidades de inversion or “UDIS”) on the date on which the court resolution declaring insolvency is issued.

The UDIS is a unit of account with value in Mexican pesos determined on the basis of the National Consumer Price Index and published by the Central Bank of Mexico in the Federal Official Gazette.

Tax Incentives

Tax incentives can also be used to establish a short-term agreement. Under the LCM, as of the declaration of insolvency, tax claims continue to accrue fines, updates and other

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4 Article 122. The creditors may request the recognition of their credits:
I. Within twenty calendar days following the date of the latest publication of the business reorganisation judgment at the Federal Official Gazette;
II. Within the term granted to object to the provisional list referred to in Article 129 of this Act; and
III. Within the term to file an appeal against the credit recognition, ranking and preference judgment. After the term mentioned in Section III, no credit recognition may be requested.
applicable charges but, in case of an agreement, all such fines and charges are cancelled. The judgment by itself does not interrupt the payment of contributions “for they are necessary for the ordinary operations of the company” (Article 69).

Sale of Debtor’s Assets

The LCM places special emphasis on the sale of the debtor’s assets and the payment to recognised creditors, and provides that the transfer of assets will be achieved, in the first instance, through public auction, if, at the discretion of the trustee in bankruptcy, it is not beneficial to continue with the operation of the business. Aside from the auction, the trustee in bankruptcy may request court authorisation to sell assets when this will enable him to obtain a larger profit. This provision has been harshly criticised and even deemed unconstitutional because the powers given to the trustee in bankruptcy go beyond what is reasonably necessary to achieve the objectives of the bankruptcy.

One of the main improvements brought in by the LCM lies in the time periods it allows, including the six-month period that begins with the commencement of the bankruptcy stage, and during which any interested party may offer to buy any asset(s), if any are left, by making an offer to the court. Again, the Institute will prepare the appropriate formats and mechanisms.

The trustee in bankruptcy has to inform the court at least every two months of the status of the remaining assets and of the creditors that have not been paid. This enables the court to maintain control over the situation, and allows the trustee in bankruptcy more responsibility for his duties.

Insolvency with a Restructuring Agreement

The LCM does not explicitly provide for informal out-of-court restructurings prior to insolvency. However, the LCM establishes that a debtor that is in imminent default on the payment of its obligations and creditors holding defaulted and unpaid obligations representing the majority of the total obligations of the debtor may file together the petition of insolvency using a reorganisation agreement. This is subject to approval by the judge and the recognised creditors of the debtor during the conciliation period (360 days, during which creditors decide whether to approve the restructuring agreement).

The court will declare the insolvency and order the commencement of the conciliation stage (or will dismiss the case). The participation of the visitor is not necessary.

The proceeding will be the same as the ordinary insolvency proceeding, and may include the appointment of a conciliator agreed to by the debtor and a majority of its creditors.

Corporate Restructuring

As a result of the amendment dated 10 January 2014, insolvency proceedings from companies that belong to an integrated corporate group will be joined but handled separately. An integrated corporate group comprises controlling companies and controlled companies.

For the purposes of the LCM, a controlling commercial company means a company that:

- Owns over 50% of the voting shares of one or more other controlled companies, including when such ownership is held through other companies that are, in turn, controlled by the same controlled company; and
Has the decision-making power at stockholders’ meetings, can appoint most of the members of its Board of Directors or otherwise has the authority to make fundamental decisions of the company.

The shares owned by a controlling company that owns over 50% of a company’s voting shares, directly or indirectly (or both), are considered to be controlled shares. Also, controlled companies are those in which administration, strategies and main politics are conducted by a controlled company by means of the percentage of the voting shares, agreements, etc.

Notwithstanding the foregoing, companies of the same corporate group can jointly request the declaration of insolvency. For the joint request to be admissible, it is only necessary that one of the requesting companies has generally defaulted on the payment of its obligations (Articles 10, 11, and 20bis), and that such default places one or more of the other companies of the corporate group in the same situation.

Creditors might also claim the joint declaration of insolvency of companies of the same corporate group when the previous requirements are fulfilled.

In any case, assets of each company will be handled separately.

Proceedings for controlling or controlled companies, or for a group of companies, are the same as the proceedings for any other kind of individual company requesting insolvency proceedings or bankruptcy.

Nevertheless, under the amendment dated 10 January 2014, a vote of affiliates, controlling companies, or controlled companies with respect to the approval of the creditors’ agreement is restricted. When subordinated creditors represent 25% of the total amount of the recognised creditors, then the creditors’ agreement will only be approved when creditors representing 50% of the total amount of recognised claims, minus the subordinated claims, voted in favour of the agreement.

Special Insolvency Proceedings

Like the BSPL, the LCM also regulates special insolvency proceedings, e.g. in the cases of debtors that provide public services under a government concession, financial institutions and credit auxiliary institutions. Following an amendment dated 10 January 2014, the LCM distinguishes among financial institutions, credit institutions and credit auxiliary institutions. As a result of this distinction, the LCM now regulates only the insolvency of financial institutions and credit auxiliary institutions. The insolvency of credit institutions is regulated by a special “judicial liquidation” proceeding under the Law of Credit Institutions.

The LCM does not regulate special insolvency proceedings regarding insurance companies or bond institutions; however, the LCM in its transitory articles establishes that they will be regulated by their own special laws.

Liability and Criminal Aspects

Under the amendment dated 10 January 2014, members of the Board of Directors, and key employees of the debtor, will be liable for economic damages caused to the debtor. Damages can be claimed by the debtor or by shareholders of the debtor representing 25% or more of the share capital. In the case of acts that defraud creditors, in addition to the above-mentioned persons, a claim can also be filed by one-fifth of the recognised creditors, recognised creditors representing 20% of the debtor’s obligations and the intervener. The statute of limitations of the claim for damages is five years starting on the day the act causing damages occurs.
The LCM sanctions wilful fraudulent acts (conductas dolosas) of debtors or creditors in insolvency proceedings. Under Article 271 of the LCM, amended on 10 January 2014, a debtor who is declared, by res judicata judgment, to be in insolvency will be sanctioned with imprisonment of between 3 and 12 years for any fraudulent act or conduct that causes or worsens the default on his payment obligations.

Also, following the amendment dated 10 January 2014, Article 271bis establishes that members of the Board of Directors, the general manager, sole administrator and key employees will be sanctioned with imprisonment of between 3 and 12 years for acts causing economic damages to the debtor when executed for their own benefit. The sanction will be reduced to imprisonment of between one and three years when damages are paid to the debtor.

Likewise, a debtor who does not provide the court with the required accounting information within the term ordered by the court will be sanctioned, unless he can prove that it was impossible for him to comply with the order and that this impossibility was not caused by him. The law also provides that a creditor who by himself or through someone else requests in the insolvency procedure the recognition of a non-existent or simulated claim will be sanctioned with imprisonment of between one and nine years.

Under Article 276 of the LCM, when a crime is committed in an insolvency situation, the criminal court does not have jurisdiction to declare damages, as they can only be declared by the court conducting the insolvency proceeding. Note that under Article 277, the decisions taken by the court conducting the insolvency proceedings do not affect the criminal prosecution, as they are not necessary to prosecute such crimes.

International Cooperation

Pursuant to the LCM, cooperation in international proceedings applies when: (i) a foreign court requests assistance in Mexico with regard to a foreign proceeding; (ii) the assistance of another country is requested in regard to a proceeding that is being conducted under the LCM; (iii) insolvency or bankruptcy proceedings are being conducted simultaneously and with regard to the same debtor in Mexico and in a foreign country; or (iv) creditors or other interested parties located in a foreign country have an interest in initiating or joining a proceeding. Likewise, the LCM determines the cases in which and manner by which a foreign procedure is recognised in Mexico, and also anticipates the possibility of having parallel procedures in Mexico and a foreign country, establishing specific actions to follow.

Despite the fact that the LCM opens the door to the possibility of cooperating with other countries in this area, there still exist international agreements signed by Mexico that make it impossible to execute these types of resolutions (e.g. the Inter-American Convention on Competence in the International Sphere for the Extraterritorial Efficacy of Foreign Judgments, celebrated in La Paz, Bolivia, and published in the Official Gazette on 28 August 1987). We believe, however, that this is a reflection of the broad view approach that is taking place in Mexican law with regard to international cooperation in the area of insolvency.

### Timeline for Insolvency Proceedings according to the LCM

| A | Filing of complaint for declaration of insolvency (concurso mercantil) | 0 (business days) |

*The days estimated in this timeline are counted cumulatively as of the date on which the complaint for the declaration of insolvency is filed (Day 0). Our estimates are generally based on statutorily mandated time periods. However, several of the time periods are uncertain and subject to interpretation. Because the statute is quite recent, there are no binding precedents that may be relied upon to clarify such uncertainties. For this reason, our time estimates are provided only for purposes of illustration.*
<table>
<thead>
<tr>
<th></th>
<th>Timeline for Insolvency Proceedings according to the LCM</th>
<th>Days* (business days)</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>Acceptance of complaint by the court</td>
<td>5</td>
</tr>
<tr>
<td>C</td>
<td>Service of process on debtor</td>
<td>5</td>
</tr>
<tr>
<td>D</td>
<td>Request by the judge for the Institute to appoint an official “visitor” who will verify existence of grounds for insolvency declaration</td>
<td>4</td>
</tr>
<tr>
<td>E</td>
<td>Appointment of visitor by the Institute</td>
<td>9</td>
</tr>
<tr>
<td>F</td>
<td>Notice of appointment to visitor</td>
<td>10</td>
</tr>
<tr>
<td>G</td>
<td>Court order for visitor to initiate verification process</td>
<td>10</td>
</tr>
<tr>
<td>H</td>
<td>Debtor’s answer to complaint</td>
<td>12</td>
</tr>
<tr>
<td>I</td>
<td>Notice to complainant (creditor) of debtor’s answer</td>
<td>13</td>
</tr>
<tr>
<td>J</td>
<td>Notice of acceptance of appointment by visitor and designation of visitor’s working team</td>
<td>15</td>
</tr>
<tr>
<td>K</td>
<td>Initiation of inspection visit</td>
<td>15</td>
</tr>
<tr>
<td>L</td>
<td>Court order notifying the parties of appointment of visitor</td>
<td>16</td>
</tr>
<tr>
<td>M</td>
<td>Complainant’s rejoinder</td>
<td>16</td>
</tr>
<tr>
<td>N</td>
<td>If debtor does not answer complaint – declaration of insolvency</td>
<td>17</td>
</tr>
<tr>
<td>O</td>
<td>Evidence stage</td>
<td>46</td>
</tr>
<tr>
<td>P</td>
<td>Presentation of visitors who should report to court</td>
<td>46</td>
</tr>
<tr>
<td>Q</td>
<td>Submission of pleadings by parties</td>
<td>51</td>
</tr>
<tr>
<td>R</td>
<td>Court’s ruling on declaration of insolvency</td>
<td>56</td>
</tr>
<tr>
<td>S</td>
<td>Notice of declaration of insolvency to parties, Institute, tax and other authorities and other creditors</td>
<td>57</td>
</tr>
<tr>
<td>T</td>
<td>Appointment of conciliator by the Institute</td>
<td>62</td>
</tr>
<tr>
<td>U</td>
<td>Publications and recording of declaration of insolvency</td>
<td>67</td>
</tr>
<tr>
<td>V</td>
<td>Conciliation period – time during which creditors approve the restructuring agreement proposed by debtor or not</td>
<td>Up to one calendar year as of the declaration of insolvency</td>
</tr>
<tr>
<td>W</td>
<td>Filing of preliminary list of creditors by conciliator</td>
<td>97</td>
</tr>
<tr>
<td>X</td>
<td>Appearance and filing of arguments regarding list of creditors by the creditors and the debtor</td>
<td>102</td>
</tr>
<tr>
<td>Y</td>
<td>Filing of definitive creditors list by conciliator</td>
<td>103</td>
</tr>
<tr>
<td>Z</td>
<td>Ruling by court recognising the valid claims and their order of preference</td>
<td>108</td>
</tr>
<tr>
<td>AA</td>
<td>First period to request recognition and order of preference by</td>
<td>67–87</td>
</tr>
<tr>
<td></td>
<td>Timeline for Insolvency Proceedings according to the LCM</td>
<td>Days* (business days)</td>
</tr>
<tr>
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<tr>
<td>any creditor</td>
<td>Second period to request recognition and order of preference by any creditor</td>
<td>97−102</td>
</tr>
<tr>
<td>CC</td>
<td>Appeal of ruling by court recognising valid claims and order of preference</td>
<td>112</td>
</tr>
<tr>
<td>DD</td>
<td>Third and final period to request recognition and order of preference by any creditor</td>
<td>108−112</td>
</tr>
<tr>
<td>EE</td>
<td>If conciliation (i.e. agreement on restructuring plan proposed by debtor among recognised creditors and debtor) is not reached, the bankruptcy stage will be initiated by the appointment of a trustee in bankruptcy (former conciliator) who will evaluate how to liquidate the assets (as ongoing business or by units) and pay the recognised claims by their order of preference</td>
<td>From the conclusion of the conciliation period and until all assets of the debtor are liquidated to satisfy recognised claims</td>
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</tbody>
</table>

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The Netherlands

Overview and Introduction

There are three main types of insolvency proceedings in the Netherlands. A distinction is made between personal insolvency and the insolvency of corporate entities, with a further distinction being made for the latter between insolvencies aimed at liquidation and at continuation.

Applicable Legislation

The most relevant Dutch insolvency legislation ("Faillissementswet"; hereinafter the "Dutch Bankruptcy Act" or the "DBA") dates back to 1893 and has since then only been slightly amended. The European Directives on the reorganisation and winding-up of insurance undertakings and credit institutions have been implemented in the DBA.

In addition to the DBA, EU legislation has a direct impact on Dutch insolvency law. The most important example is the EU Insolvency Regulation (EC No. 1346/2000 on insolvency proceedings), which is directly applicable in the Netherlands. The main goals of the regulation are to create recognition in EU member states of judgments concerning the opening of insolvency proceedings and to set out rules for applicable law issues. The UNCITRAL Model Law on Cross-Border Insolvency has not been adopted in the Netherlands.

The collapse of certain Dutch financial institutions, as well as the global financial crisis, have given rise to a lot of debate as to whether the DBA can still be considered fit to deal with today’s economic realities and the highly complex financial issues that arise in bankruptcies. Although preparatory work for revising the DBA has been on-going for many years, no bill has yet found its way into legislation. Moreover, a proposal for a complete overhaul of the DBA, produced by the association for insolvency specialists INSOLAD in 2012, has not found any substantive follow up.

As the legislator continues to fail to modernise the DBA, insolvency practitioners – with the assistance of bankruptcy judges – have developed a practice that overcomes the major issue of “loss of value” associated with bankruptcies. This practice, in essence, has created the option of a pre-packaged bankruptcy filing, which is missing under the DBA. In such cases, before filing for bankruptcy or suspension of payment, the company’s management, shareholder or (third party) investor and/or purchaser prepares a plan to acquire or sell certain parts of the business out of the (bankrupt) estate and continue business in another company standing at the ready. Following the preparation of such plan, the court may be asked to appoint a “silent administrator” prior to the request for bankruptcy (or suspension of payment) to ensure that the pre-pack plan is acceptable to the administrator and the bankruptcy judge. This process will prevent delay and limit actions on the basis of fraudulent preference (possibly voiding the sale of the business) and allows (part of) the business to be sold as a going concern. There is currently no statutory basis for the appointment of the “silent administrator,” and the process is sometimes heavily criticised for its lack of transparency. However, all but two courts allow it, albeit certain requirements have to be met before an application for appointing a “silent administrator” will be considered by the courts.

In general, the upside of a restart through bankruptcy is that the purchasing company will be able to continue the business with a clean slate, being freed of the burden of costly employees (as cherry-picking is possible and transfer-of-undertaking regulations for a large part do not apply), certain other disadvantageous contracts and old debts. The downsides may be that other interested parties will address the trustee to try and win the healthy components of the business; and negative publicity, which is intrinsically connected to
insolvency. If the bankruptcy was not preceded by a silent administration and the trustee feels that the sale is not in the best interests of the combined creditors or that public interests bar such a sale, he is at liberty to set aside the pre-pack, although the bankruptcy judge may be addressed if the trustee chooses a clearly unreasonable path. These downsides can – to a certain extent – be remediated by requesting the appointment of a silent administrator prior to filing bankruptcy (or suspension of payment). The silent administrator would review whether a deal with a party other than the envisaged purchaser would be more beneficial to the combined creditors.

Personal Insolvency

One type of insolvency proceedings provided for in the DBA is the “debt reorganisation of natural persons”, an alternative to the bankruptcy of a natural person. Restrictions apply: after a three-year period of strict financial control, the debtor will be freed of its debt. For the purpose of this chapter, no further attention will be given to this type of insolvency.

Corporate Restructuring/Reorganisation

As far as debt restructuring outside formal insolvency proceedings is concerned, a debtor may offer its creditors a composition in the form of an agreement. It may also enter into other informal arrangements (standstill agreements with creditors, contractual compromises, etc.). If successful, debt restructuring outside of insolvency may provide for a more advantageous situation; for instance, when it is important to avoid undesired publicity and/or the “lack of confidence” effect connected to formal insolvency proceedings and/or to avoid triggering insolvency-related contractual clauses.

However, such compositions cannot generally be forced upon unwilling creditors and the chance of success is therefore usually limited. Creditors are generally not willing to join a composition or debt restructuring plan unless it involves all creditors, opening the door for opportunistic funds to try and leverage their position, absent a cram-down mechanism. Furthermore, creditors are often unwilling to accept a haircut, unless they are sure that the debtor is indeed in financial difficulty, while the debtor may not be prepared to provide full financial insight. Creditors, on the other hand, may not be willing to spend cash on due diligence, when there is a possibility their claims are not going to be paid. A scheme outside of insolvency proceedings does not involve court approval, therefore no objective test is applied as to whether the situation is really as presented. Creditors may refuse to join the composition or debt rescheduling without loss of rights. It is not possible to force creditors to accept. Only in extraordinary circumstances will a refusal be considered wrongful. It would need to constitute an abuse of law or be contrary to the principles of reasonableness and fairness. This very rarely occurs. We note that there are legislative changes on the horizon that, if accepted, will result in creditor cram-down outside of bankruptcy.

Court-Based Insolvency

The two primary insolvency regimes under Dutch law are suspension of payment (“surseance van betaling”) and bankruptcy (“faillissement”). The first is intended to grant temporary relief from a debtor’s payment obligations and may be used to facilitate the reorganisation of a debtor's obligations and enable the debtor to continue its business as a going concern. The latter is aimed at liquidation of the debtor’s assets and subsequent distribution among its creditors. There is also an emergency regulation for insolvent financial institutions, but this will not be discussed in this chapter.
Suspension of Payment

A (legal entity) debtor may file for suspension of payment itself (together with an attorney-at-law) by means of a petition to the district court in the district it is incorporated. The “test” is that the debtor foresees that it will not be able to pay its debts as they fall due (i.e. a liquidity test). The debtor must provide the court with several exhibits including, but not limited to, an overview showing its current assets and liabilities. The debtor may choose to include a draft creditor composition plan with its petition.

If the statutory conditions have been met, the court will immediately grant a provisional suspension of payment without evaluation of the merits. One or more administrators will be appointed to act alongside the authorised representatives of the company (its directors). An administrator is an independent third person (usually an attorney-at-law) that will periodically report on the status of the company. Unless creditors representing a certain amount of debt declare themselves against the final suspension, and provided that the court finds the existence of prospects that suggest in due course the debtor will be able to meet its obligations, the court may grant a final suspension of payment.

Consequences of Suspension of Payment

During the (provisional and final stages of a) suspension of payment regime, the unsecured creditors are barred from recovering their claims against the debtor’s assets, and enforcement measures already taken are suspended by operation of law. Any attachments levied against the company are lifted. Suspension of payment therefore provides only a certain amount of breathing room. The questions of if and how the company will be able to survive are leading during the suspension of payment regime. If survival is not a realistic option, bankruptcy must subsequently be requested.

After the suspension of payment has been granted, the directors of the company no longer have the authority to represent the company on their own. The administrator also does not have this authority. Save for a few exceptions, the company can only be legally represented by both the directors and the administrator together.

Secured creditors and certain preferential creditors (such as tax and social security authorities) are generally excluded from the operation of the suspension of payment. This means that secured creditors having a right of pledge or mortgage on certain assets may enforce these rights seeking recourse for their claims. The same goes for certain preferential creditors. One or two other exceptions apply.

As in bankruptcy, a cooling-off period may be ordered. This will temporarily prevent even secured creditors or third parties whose property is located at the bankrupt company from enforcing their claims.

Composition

During the suspension of payment, the debtor may offer its unsecured and non-preferential creditors a composition. The DBA does not prescribe the contents of a scheme of arrangement. Usually, the debtor offers to pay a percentage of the claims against final settlement. The debtor may, however, offer a different type of scheme. For example, payment in instalments, payment through future profits, conversion of debt to equity, or simply an extension of payment terms. If many creditors are involved, the composition may include full payment of debts below a certain amount, as it may be considered too burdensome/costly to address all such (relatively) small creditors.

If a composition is offered, the court will convene a meeting of the unsecured, non-preferential creditors in order to allow them to vote on the draft composition. If a majority of
the admitted creditors representing at least half of the total amount of the admitted claims, approve the composition, it is submitted to the court for approval.

Should the composition be rejected by the creditors, it may still be approved by the court on request, if three quarters of the admitted creditors that appeared at the meeting voted in favour of the composition and if the rejection of the composition was the result of creditors voting against the composition on unreasonable grounds.

The court will refuse the approval of the composition if:

- The assets (minus liabilities) of the estate considerably exceed the amount offered in the composition;
- The successful outcome of the composition is insufficienlty guaranteed;
- The composition involves fraud, etc.;
- The fees and disbursements of the administrator and experts (who performed services for the administrator) are not taken into account; or
- An insolvency trustee opened main proceedings outside the Netherlands, unless the composition does not adversely affect the financial interests of the creditors in the principal proceedings.

The court may base its decision to refuse approval on other grounds as well. The decision of the court to approve the composition (or to refuse) is subject to appeal. Once approved, all creditors affected by the suspension of payment are bound by the composition.

End of Suspension of Payment

When all creditors have been satisfied in full, the suspension will end. If a composition is accepted by both the creditors and the court, the suspension of payment regime also ends and the unpaid portion of the creditor’s claims is generally waived. A third manner in which the suspension of payment may end is by revocation followed by a bankruptcy.

Upon recommendation by the bankruptcy judge (if appointed) or upon request of an unsecured creditor or the administrator – for example in case of fraud by the directors or their unwillingness to cooperate with the administrator – the court may conclude that it is undesirable to continue the suspension in effect. It may also do so if it appears unlikely that the debtor will be able to satisfy its creditors in the course of time. The court may declare the company bankrupt in the same decision. Other, less frequented, grounds for revocation of the suspension of payment also exist.

Bankruptcy

Objective

Bankruptcy is aimed at liquidation and maximising recourse for the benefit of the joint creditors. The test is whether the debtor fails to make the payments to its creditors when they fall due (i.e. a liquidity test).

Formalities

A bankruptcy petition may be addressed to court by both the debtor itself and by (one of) its creditors. The latter is generally referred to as involuntary bankruptcy proceedings. Formally, the public prosecutor may also file for bankruptcy, although this rarely occurs. The
competent court is the court in which district the company is incorporated. This court will declare the debtor bankrupt in cases where the debtor has ceased to pay its debts as they fall due.

Where a creditor petitions the court, it should demonstrate facts and circumstances constituting the plurality of creditors. This means that a sole creditor cannot file a petition without at least possessing knowledge of other creditors having unpaid debts. Note that these other creditors are not required to support the petition, although the courts are backtracking somewhat on this issue, since other creditors may be in support of restructuring discussions.

Where the debtor itself files for bankruptcy, it should attach various exhibits to the petition. Among the most important are the articles of association, a shareholder’s resolution to petition the bankruptcy and an up-to-date overview of assets and liabilities evidencing the financial state of the company.

If the court grants the petition for bankruptcy and the debtor was not present at the hearing of the court handling the petition, it may file an opposition to the judgment with the court itself, possibly followed by an appeal against the decision regarding the opposition. If the debtor was present at the hearing, the bankruptcy ruling may be appealed before the Court of Appeal. A creditor whose petition for the bankruptcy of its debtor has been dismissed, directly or following opposition by the debtor, also has a right of appeal. The periods for appeal and opposition are short.

Consequences of the bankruptcy

The bankruptcy judgment generally has retroactive effect until midnight on the day it was rendered.

The “principle of fixation” results in an automatic general arrest over the debtor’s assets. Unsecured creditors can no longer enforce their claims, but must submit these to the trustee. Attachments that have been levied against the company will be considered lifted, as the bankruptcy itself is considered an (almost) all-encompassing attachment on the assets of the bankrupt company.

To allow the trustee some time to gain insight into the situation without the estate being torn apart by various claiming parties, a cooling-off period may be ordered. This will temporarily prevent even secured creditors or third parties whose property is located at the bankrupt company from enforcing their claims.

The court will appoint one or more bankruptcy trustees (an independent administrator: usually an attorney-at-law) that will work under the supervision of a bankruptcy judge. The debtors and creditors cannot choose who this trustee is, but a request can be made that an experienced trustee is appointed if the bankruptcy is complex. The trustee is required to periodically report to the judge. These reports are made available to the public and serve as a valuable – though sometimes somewhat outdated – source of information to the creditors.

The trustee is (solely) entrusted with the administration and liquidation of the bankrupt estate. The company’s directors are no longer authorised to represent the company to the extent that the company’s assets are affected. The trustee requires and has a right to information about the administration of the company and will make an inventory of assets. The trustee will usually sell off all assets and will aim at maximising the proceeds. He may terminate certain types of agreements (including employment and lease agreements: with short statutory notice periods). The trustee is also authorised to default on certain contractual obligations (to perform or tolerate) and cannot generally be forced to fulfil the debtor’s obligations vis-à-vis its creditors. Alternatively, he may also decide to continue the
business for a certain period of time, if such continuation is in the best interests of the combined creditors and stakeholders. Public interests may also play a role.

We note that the company’s directors still have the obligation to file its annual accounts, even during suspension of payment or bankruptcy.

**Restart (Purchase out of the Bankrupt Estate)**

If the opportunity arises, a trustee will sell (part of) the debtor’s business to an interested party. Usually higher revenue can be achieved by selling the business as a whole or in part by private treaty, than by organising a public auction to sell off all the individual assets. The trustee may conclude asset transactions, but will require permission from the bankruptcy judge. Such sales may, to a certain extent, be prepared prior to bankruptcy, possibly in cooperation with secured creditors such as banks, but the trustee is not compelled to sell to any one party (for instance to former management or a new company set up for his purpose). He may choose the party with the best proposal. Although his attention mainly remains with the combined creditors’ interest (i.e. the highest bid), the trustee will recognise other (public) interests, such as continuation of employment, when considering proposals.

**Registration of Claims**

All claims, except secured claims or claims against the estate, must be filed for verification with the trustee. Unless the court has fixed a date for the claims validation meeting (“verificatievergadering”), there is usually no time limit within which claims must be filed (i.e. no standard claims filing date). Claims must be filed in writing and substantiated by proof. Prior to a claims validation meeting, the trustee will make a list of the claims he either provisionally admits or challenges. An online tool has been developed for creditors to submit their claims through a centralised process.

Claims against a bankrupt debtor can only be verified in euros. As a general rule, interests over any claim may only be verified insofar as they have fallen due prior to the bankruptcy date. When valuating financial instruments such as notes accelerated after the bankruptcy date, interest over the period following bankruptcy may to a certain extent still be taken into account. Depending on the financial instruments involved and the moment of acceleration, a discount may be applied to the valuation in order to arrive at the amount of the claim admitted for validation.

The court will only fix a date for the claims validation meeting if unsecured claims can be (partially) paid. In such cases, the court will also fix a date prior to which any claims must be filed. The period between these dates must be at least 14 days. At the claims validation meeting the trustee, the managing director(s) and the creditors will meet under the presidency of the court, in order to discuss all claims against the debtor. Each of them may contest the validity of any claim. If the court does not succeed in bringing the parties involved in contesting a claim to a settlement, the parties will be referred to a regular court procedure (claims validation proceedings), in which the competent chamber of the court will rule on the validity of the claim at stake. As soon as all claims are finally verified or referred to a court procedure, the trustee will deposit lists of the creditors at the office of the court clerk. If these lists meet no opposition within 10 days after their deposit, they become irrevocable and binding.

If the estate does not have the means to pay (part) of the claims of the ordinary creditors, the trustee can request or the bankruptcy judge can decide that there will be no claims validation meeting. In that case, the trustee will simply wind up the business, liquidate the assets of the estate and terminate all pending matters, after which the bankruptcy will be terminated by the court due to a lack of assets. In such cases, no payment will be made to any unsecured, non-preferential creditor. The creditors known to the trustee will be informed of this.
Claim Ranking and Priorities

A leading principle of Dutch bankruptcy law is the *paritas creditorum*, which means that all creditors have an equal right to the debtor’s assets and that the proceeds of the bankrupt estate are distributed among them *pro rata parte*. However, there are creditors to whom the principle of *paritas creditorum* does not apply:

- Creditors that hold a security interest; and
- Creditors that have a preference by virtue of law.

Therefore, the *paritas creditorum* applies to those who have an unsecured claim and do not have a right of preference, i.e. the ordinary creditors share *pro rata parte* in the amount available to them. A further exception can be made for subordinated claims.

**Secured Creditors**

The most important secured creditors are those who:

- Hold a mortgage; or
- Hold a pledge.

Creditors who hold a security interest may exclude the collateral from the debtor’s estate and enforce their rights: the creditor is entitled to prompt foreclosure even if the debtor was adjudicated bankrupt. A secured creditor may therefore act as if there were no bankruptcy. The mortgagee and the pledgee are both entitled to auction off the collateral without the cooperation of the trustee; they are further entitled to deduct the sums owed by the bankrupt debtor from the proceeds of the auctioned property. The excess proceeds, if any, are then handed over to the trustee. An agreement may also be entered into with the bankruptcy trustee regarding a private sale, if the proceeds thereof are expected to at least equal the proceeds of an auction. The trustee may in fact arrange this private sale on behalf of the secured creditor, for which this creditor will generally pay a contribution to the estate.

The automatic stay of all actions against the debtor, which results from an adjudication of bankruptcy (fixation), does not apply to secured creditors. Note, however, that a secured creditor cannot remove any assets from the estate during a cooling-off period. Furthermore, the trustee is obligated to respect the interests of those with higher ranking claims. If there are insufficient unsecured and unencumbered assets in the estate to pay higher ranking creditors (e.g. certain tax claims and rights of retention), the trustee may claim (part of) the proceeds achieved by the secured creditors through the sale of secured assets.

The trustee is entitled at all times to have the collateral released from a mortgage or a pledge by paying the mortgagee or the pledgee the amount owed by the bankrupt debtor. If the amount the debtor owes to the mortgagee exceeds the principal sum specified in the mortgage, the trustee may release the property by paying the portion of the debt attributable to the mortgage. The mortgagee must then release the collateral from the mortgage.

The trustee is in principle not entitled to retain the encumbered property. If the secured creditor obtains payment of his claims by executing on the security, he will not be charged with bankruptcy costs. However, if the secured creditor does not enter into an agreement with the trustee regarding the sale of the assets concerned, nor make timely use of its enforcement rights, the trustee may sell the assets concerned itself. In such case, the secured creditor will still have priority as to the proceeds, but it will need to share in the bankruptcy costs (which may well exceed the proceeds).
Creditors that have the right of ownership of personal property (e.g. through retention of title/reservation of ownership) also have a very strong position in bankruptcy, comparable to that of secured creditors.

**Preferred Creditors**

There are two categories of preferred creditors:

- Creditors who have a statutory priority; and
- Creditors who have a non-statutory priority.

Most preferred creditors are not entitled to initiate foreclosure proceedings. They are required to present their claims to the trustee and are charged their pro rata share of the costs of the bankruptcy.

**Creditors with a Statutory Priority**

Preferential rights are created by specific, limited statutory provisions only. These rights create a preference regarding the distribution of the proceeds of the liquidation. They may relate to all of the debtor’s property or to specific property only. If the trustee recognises the preference, and unless another creditor has a higher priority, the preferred creditor will be the first to receive payment from the proceeds of the collateral. The creditor who has priority over the proceeds of goods delivered by him should notify the trustee of his preference. If the creditor fails to notify the trustee before the trustee sells the goods to which the preference relates, the creditor runs the risk that his preference will not be acknowledged.

The preferences of the tax and social security administrations are among the highest in rank. Even after an adjudication of bankruptcy, the tax administration has the right in certain circumstances to attach movable property located “on the premises” of the debtor. This may include the property of third parties and can be enforced even after an adjudication of bankruptcy (or a suspension of payment), but only as far as it relates to the property of third parties.

**Creditors with Rights which Operate as Priority**

Some creditors are in the position of having a right, which de facto operates as a priority. The main rights enabling the creditor to enforce such a “priority” are the right to retain property, retention of title, and the right of set-off.

The right to retain property is a statutory remedy available to certain types of creditors who may refuse to surrender possession of goods as long as the outstanding debt remains unpaid. An adjudication of bankruptcy does not affect the right of retention. For example, prior to being declared bankrupt, a debtor brings his car to the garage for repairs. Under Dutch law, the garage owner may be entitled to withhold the car until he is paid for the repair charges by the bankruptcy trustee.

Set-off is a means by which the debts between two parties are discharged through cross demands which cancel each other out. This right is governed by both the Dutch Civil Code and the DBA. The possibilities for set-off in bankruptcy are somewhat broader than outside of bankruptcy. For the right of set-off to be used in bankruptcy, both the claim and the debt must exist before the adjudication of bankruptcy, or must originate from acts performed prior to the bankruptcy.


**Estate Creditors**

Certain claims are regarded as “claims against the estate”. They generally arise following an adjudication of bankruptcy and ensue from either statutory provisions or from actions by the trustee (“toedoen”). These claims have priority over other claims. Estate claims do not have to be submitted to the trustee for validation and are immediately enforceable against the estate, though in practice there is often a delay in payment, especially if it is uncertain whether there are sufficient assets to pay all estate creditors (in which case the trustee generally applies a ranking of estate claims). Examples of estate claims are:

- The costs and salary of the bankruptcy trustee;
- The costs of liquidation the estate;
- Claims ensuing from obligations that arise following the bankruptcy adjudication to the extent that the estate benefits from this;
- The wages of employees as of the date of the bankruptcy adjudication, for a maximum period of six weeks following dismissal by the trustee, including holidays not taken and the commutations of pensions;
- Lease or rent as of the date of the bankruptcy adjudication, for a maximum period of three months following termination of the lease agreement by the trustee;
- Claims that ensue from acts performed by the trustee, including agreements entered into by the trustee, but also claims that ensue as a result of omissions by the trustee.

Claims against the company that arise after the adjudication of bankruptcy and that are not considered estate claims generally cannot be validated and will not receive a share of the proceeds.

**Unsecured Creditors**

As explained above, the equality of all creditors (“paritas creditorum”) is an underlying principle of Dutch bankruptcy law. It applies to all unsecured creditors that do not have any preference. They will only (partially) be paid if there are sufficient remaining proceeds after all other (preferred, estate, secured) creditors have received payment.

Composition

During the bankruptcy, the debtor may offer its unsecured creditors a composition. If such cases, the court will convene a meeting of unsecured creditors in order to vote on the draft composition. If a majority of the admitted unsecured creditors representing at least half of the total amount of claims approve the offer for a composition, it is submitted to the court for approval. All unsecured creditors are bound by such a court approval. Should the composition be rejected by the creditors, it may still be assumed approved on request, if three quarters of the recognised creditors that appeared at the meeting voted in favour of the composition and if the rejection of the composition was the result of creditors voting against the composition on unreasonable grounds.

The court will refuse the approval of the composition if:

- The assets (minus liabilities) of the estate considerably exceed the amount offered in the composition; or
- The successful outcome of the composition is insufficiently guaranteed; or
• The composition involves fraud, etc.; or

• An insolvency trustee opened main proceedings outside the Netherlands, unless the composition does not adversely affect the financial interests of the creditors in the principal proceedings.

The court may base its decision to refuse court approval on other grounds. The decision of the court to approve the composition (or to refuse) is subject to appeal.

Clawback and Recovery Mechanisms

A fundamental principle of Dutch law is that a debtor is free to dispose of its assets as it sees fit. There are, however, some restrictions to this freedom. If this disposal of assets is detrimental to the recourse possibilities of its creditors and is, furthermore, non-obligatory, Dutch civil law and bankruptcy law provide claw back and recovery possibilities, which are referred to as “Actio Pauliana”. Pauliana inside and outside of bankruptcy provides the trustee/creditor(s) with the option to invoke the invalidity of certain legal acts. Pauliana has been accepted by Dutch courts under varied circumstances, e.g. in cases of payment of debts, set-off, establishing of security and even the payment of dividends. The case law is extensive and at times complex.

Outside of bankruptcy, any and all disadvantaged creditors may invoke article 3:45 of the Dutch Civil Code. In bankruptcy, only the trustee has a right to invoke pauliana. He can do so on the basis of article 42 of the DBA and only for the benefit of the entire bankruptcy estate. Creditors may still file a claim against the debtor during bankruptcy on the basis of a wrongful act when fraudulent preference occurs, but the trustee’s claim may be considered to take priority over such a claim. Pauliana can be invoked inside and outside of court. In the latter case a written statement must be provided to the parties concerned in which the pauliana is invoked.

In order for pauliana to apply:

• The legal act must be non-obligatory (not mandatory by law or contract);

• The legal act must have prejudiced the creditors (in bankruptcy the combined creditors; outside of bankruptcy one or more creditors); and

• If the legal act was performed in exchange for consideration, the creditor/trustee must prove that both the debtor and the other party knew that the act would prejudice the creditor at the time the legal act was performed.

If no consideration was concerned (e.g. a donation or payment well below the actual value), the creditor/trustee must only prove that the debtor knew he acted to the detriment of creditors in order for pauliana to be accepted at the time the legal act was performed.

Third parties may, under certain circumstances, remain unaffected by the pauliana if they acted in good faith and – if there was no consideration for the legal act – if the third party did not benefit in any way from the legal act at the time pauliana was invoked (outside of bankruptcy) or the bankruptcy was adjudicated (inside bankruptcy).

The knowledge that a legal act would prejudice the debtor’s creditors is presumed by law for all transactions performed in case of bankruptcy: within one year of an adjudication of bankruptcy, and outside of bankruptcy: within one year of invoking pauliana, when it can also be established that the transaction meets the criteria of one of the following categories:
- Transactions in which the debtor received substantially less than the value that was given by the debtor;

- Payment of, or granting of security for, debts which are not yet due;

- Transactions entered into by the debtor-natural person with certain relatives;

- Transactions entered into by the debtor-corporation with its managing or supervisory director(s) or relatives to these directors or shareholders;

- Transactions by the debtor-corporation with another legal entity, provided that one of the involved entities is a director of the other, or that there are certain family ties between either the director-natural persons or the shareholder-natural persons of the involved entities; or

- Transactions by the debtor-corporation with a subsidiary or affiliate company.

Note that prejudice of the creditors may still be assumed present even if the balance sheet of the bankruptcy estate remains practically unaffected. For example, in case of a payment of debt, the assets on the balance sheet will decrease by the paid amount, but the liabilities (debts) will decrease by the same amount. On paper, there seems to be no disadvantage to the estate. However, this creditor is then paid in full, while the other creditors will only receive a pro rate share of the assets, which in bankruptcy often entails they will (at most) only receive part of their claim. This one creditor has therefore received an advantage to the detriment of the other creditors, who would otherwise have received a share of the assets now used to pay that first creditor’s claim in full. Case law provides guidance as to when this situation may apply.

The presumption of knowledge may be overcome by the debtor and/or other party by providing evidence to the contrary.

In bankruptcy, a debtor under a legal obligation to pay a certain creditor may still be confronted with pauliana if it is demonstrated by the trustee that the other party knew that a petition for bankruptcy was actually filed at the time of payment or if it is demonstrated that the legal act is a result of conspiracy between the debtor and the other party to defraud creditors. Once demonstrated, evidence to the contrary is no longer allowed.

In short, when faced with a debtor’s financial difficulties, the risk of invalidity of any ensuing legal acts to safeguard payment must be taken in account.

Dutch tax, family and criminal law also contains several pauliana provisions that are not discussed further in this Guide.

Directors’ Liability

Legislation and case law in relation to directors’ personal liability is extensive.

Liability vis-à-vis Tax Authorities

If taxes and social security contributions are not paid, the tax authorities can hold the managing directors personally liable for the unpaid amounts if the company did not timely notify the tax authorities/social institutions regarding its incapability to pay the amounts due.
Internal Liability

Only a few managerial duties are described in Dutch law. An example is the standard of care that the director should observe towards the company. A director may be held liable by the company itself – or, in case of bankruptcy, by the trustee – for the damages suffered by that company when he acts contrary to his obligations and the damages are a result of that mismanagement. The director is obliged to perform to the best of his abilities in the interest of the company and as could be reasonably expected from a competent and qualified director under the same circumstances.

For liability to be accepted there must be a serious personal reproach/fault on the side of the director. All relevant facts and circumstances must be taken in account. Not every imperfection or mistake leads to liability: the director is granted a certain degree of latitude. In principle, collective responsibility entails that all directors are severally and jointly liable for failure, although individual directors do have the opportunity to exculpate themselves when held liable. For exculpation the director must show that he is not to blame for the mismanagement and that he has not been negligent in taking measures to avert the negative consequences of the mismanagement. The board of directors may also be discharged by the general meeting of shareholders, lifting the directors from (internal) liability with regard to the management in the period relevant to the discharge. The discharge only relates to the facts that are officially known to the general meeting.

An example of improper performance is entering into irresponsible financial transactions involving great financial risks. Another example of internal liability may apply when a director forces a company to lend a large amount to a third party without stipulating security and/or interest and the third party subsequently goes bankrupt.

Note that, since January 2013, the trustee can (also) request an investigation into mismanagement of the bankrupt entity before the Dutch Enterprise Chamber (a business court). The Dutch Enterprise Chamber may implement measures itself, although in bankruptcy – with an independent third party already appointed as trustee – the establishment of mismanagement generally leads to separate civil proceedings against the directors personally.

External Liability

Under Dutch law, each director is jointly and severally liable to the bankrupt estate for the amount of the obligations to the extent that these cannot be satisfied out of the liquidation of the assets, if the directors have apparently performed their duties in an improper way and it is plausible that this is an important cause of the bankruptcy.

A successful liability claim on this basis requires apparent mismanagement of the board of directors of the company and prima facie evidence that the apparent mismanagement was an important cause of bankruptcy. Hard and fast rules do not exist on what constitutes “apparent mismanagement”. However, some legal presumptions apply: when the board of directors has not fulfilled either its obligations to maintain adequate administration of the company, or its obligations to timely publish the annual accounts and annual report of the company in accordance with legal requirements, there is by virtue of law:

- An irrefutable presumption of apparent mismanagement by the board of directors; and
- A refutable presumption that this apparent mismanagement was an important cause of the bankruptcy.
Only mismanagement performed during the period of three years preceding the bankruptcy is relevant for this type of claim. Note that the above may also be applicable to a person who is not a formal director but who is the decision maker within the company: a so-called “de-facto director” or pseudo director, such as a (director of a) dominant shareholder of the bankrupt company.

Wrongful Act

A third party – including the trustee on behalf of the bankrupt company – can hold a director liable if the director has committed a wrongful act. Most parties who hold a director liable on the basis of a wrongful act are unpaid creditors of the bankrupt company. For instance, a director can be liable for damages resulting from the default of the company to satisfy its obligations under an agreement, when the director at the time of entering into the transaction knew or reasonably should have understood that the company would not (or would not within a reasonable period of time) be able to satisfy its obligations or provide recourse for the damages resulting thereof for the creditor.

Conclusions and Additional Observations

Dutch insolvency legislation is based on generally accepted principles such as paritas creditorum. Although some of its provisions appear no longer fit to deal with highly complex financial issues, and although the DBA may well be criticised in other respects, it has done an adequate job for over a century. The reason for this may be that it allows room for development through jurisprudence. The case law is extensive and insolvency issues are therefore often complex. This guide can therefore only provide a high-level review.

Fraud and Funding in Insolvency Proceedings

The court-appointed trustee is paid out of the proceeds of liquidation of the bankrupt estate. In most cases, these proceeds are too little to pay the trustee’s fees, let alone the claims of any creditors. Some believe this system paves the way for abuse: in cases in which directors understand that are guilty of mismanagement, they often know it is beneficial to completely empty the company, leaving no means available for paying the trustee’s bill. In such cases, the trustee is unlikely to be inclined to conduct a (costly) full-blown investigation into the company’s affairs and may terminate the bankruptcy with only superficial attention and effort, providing the directors with a get-out-of-jail-free card. Trustees report fraud to the authorities in only a minor percentage of cases. Although some government funding can be requested to chase fraudulent directors, the formal requirements are of such an unappealing nature that trustees often forsake that route.

In recent years, fraud in bankruptcy has increasingly attracted the government’s attention and it can now be considered a prime concern. Comprehensive policies to act more forcefully against it have been announced and partially implemented. The sanctions and tools granted to the bankruptcy trustee and the public prosecutor in civil and criminal law will be expanded and will include, among other aspects, director disqualification for a maximum of five years in case of mismanagement. Trustees are also actively encouraged to report on fraud and may soon be given the legal obligation to investigate fraud. We expect to see start seeing changes in enforcement against bankruptcy fraud in the relatively short term.
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Overview and Introduction, Applicable Legislation

There are several remedies available to a financially distressed individual or juridical person: a financially distressed individual may apply for suspension of payments or insolvency (bankruptcy)\(^1\), while a financially distressed juridical person may apply for (i) court-supervised rehabilitation, (ii) pre-negotiated rehabilitation or (iii) an out-of-court restructuring agreement. The applicable laws and regulations are the Civil Code of the Philippines\(^2\) (the “Civil Code”), the Financial Rehabilitation and Insolvency Act\(^3\) (the “FRIA”), Presidential Decree 902-A (“PD 902-A”)\(^4\), and the Financial Rehabilitation Rules of Procedure (the “FR Rules”).\(^5\) The particular relief sought will determine the type of proceeding.

The FRIA provides for a more comprehensive framework for rehabilitation and liquidation of debtors, whether corporate or individual. Moreover, the FRIA has made available the benefits of rehabilitation proceedings to partnerships, individuals and smaller businesses. However, banks, insurance companies and pre-need companies (i.e. those that sell contracts which provide for payments at the time of actual need, such as pension and education plans), and national and local government agencies or units are not covered by the FRIA.

Each of the above remedies is discussed in more detail below.

Procedures for Solvent Debtors

Suspension of Payments

An individual debtor who possesses sufficient property to cover all of his debts but may not be able to meet them as they fall due may file a petition with a Philippine Regional Trial Court designated as a special commercial court\(^6\) (the “court”), to be subject to suspension of payments. The verified petition must be filed with the court where the debtor has resided for at least six months prior to the filing of the petition.

Action on the Petition for Suspension of Payments

If the court finds the petition for suspension of payments sufficient in form and substance, it will issue an order:

- Calling a meeting of all the creditors named in the schedule of debts and liabilities (“creditors’ meeting”);
- Directing such creditors to prepare and present written evidence of their claims before the creditors’ meeting;
- Directing the publication of the order in a newspaper of general circulation;

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\(^{1}\) Philippine law makes no distinction between bankruptcy and insolvency.

\(^{2}\) Republic Act No 386.

\(^{3}\) Republic Act No 10142.

\(^{4}\) Reorganisation of the Securities and Exchange Commission with Additional Powers and Placing the said Agency under the Administrative Supervision of the Office of the President. After the promulgation of Republic Act 8799 (the “Securities Regulation Code”), jurisdiction over petitions of corporations, partnerships or associations to be declared in the state of suspension of payments was transferred from the Securities and Exchange Commission to the Regional Trial Court. The Securities and Exchange Commission, however, retained jurisdiction over pending suspension of payments and rehabilitation cases filed as of 30 June 2000 until final disposition of such cases.

\(^{5}\) Supreme Court Administrative Matter No 12-12-11.

\(^{6}\) Supreme Court OCA Circular No. 11-2016, amending Administrative Matter No. 03-03-03-SC..
• Directing the clerk of court to cause the sending of a copy of the order to all creditors named in the schedule of debts and liabilities;

• Forbidding the individual debtor from selling, transferring, encumbering or disposing in any manner his property, except property used in the ordinary operations of commerce or of the industry in which the petitioning individual debtor is engaged, so long as the proceedings relative to the suspension of payments are pending;

• Prohibiting the individual debtor from making any payment outside of the necessary or legitimate expenses of his business or industry, so long as the proceedings relative to the suspension of payments are pending; and

• Appointing a commissioner to preside over the creditors’ meeting.

**Actions Suspended**

Upon a motion filed by the individual debtor, the court may issue an order suspending any pending execution against the individual debtor, except that properties held as security by secured creditors will not be the subject of such suspension order.

A creditor may not sue or institute proceedings to collect his claim from the debtor from the time of the filing of the petition for suspension of payments and for as long as proceedings remain pending except:

• Those creditors having claims for personal labour, maintenance, or expense related to the last illness and funeral of the debtor’s wife or children incurred in the 60 days immediately prior to the filing of the petition; and

• Secured creditors.

**Agreement for Suspension of Payments**

The petition for suspension of payments must include a statement of the debtor’s assets, a schedule of the debtor’s liabilities, and the proposed agreement with the creditors for the suspension of payments. The presence of creditors holding claims amounting to at least three-fifths of the liabilities is necessary for holding the creditors’ meeting. The proposed agreement must be approved by two-thirds of the creditors representing at least three-fifths of the debtor’s total liabilities. The proposed agreement will be deemed rejected if the number of creditors required for holding a creditors’ meeting is not attained, or if the required vote is not achieved. In such instances, the proceeding will be terminated and the creditors may enforce their claims.

If the required vote is achieved without any objection from the creditors, or the decision of the majority of the creditors to approve the proposed agreement or any amendment thereof made during the creditors’ meeting is upheld by the court, the court will issue an order that the proposed agreement be carried out, and the agreement is binding on all creditors that have been properly summoned and included in the schedule of debts and liabilities. However, the agreement is not binding upon those creditors having claims for personal labour, maintenance, or expense related to the last illness and funeral of the debtor’s wife or children incurred in the 60 days immediately prior to the filing of the petition, as well as upon secured creditors.

If the required vote is achieved but there is an objection from any of the creditors, the court will conduct a hearing on the objection. If the objection is found to be meritorious, the proceeding will terminate. If the objection is found to be unmeritorious, the court will proceed as though no objection had been made.
The amount of the debts of the debtor is not affected by a suspension of payments. However, the payment for such debts is delayed.

**Objections to the Debtor’s Proposed Agreement**

The possible grounds for objecting to the proposed agreement are:

- Defects in the call for the meeting of the creditors, in the holding thereof, and in the deliberations thereat, which prejudice the rights of the creditors;

- Fraudulent connivance between one or more creditors and the debtor to vote in favour of the proposed agreement; and

- Fraudulent conveyance of claims for the purpose of obtaining the required majority.

If the debtor fails wholly or in part to perform the court-approved agreement, the rights which the creditors had against the debtor before the agreement shall re-vest in them. In such case the individual debtor may be made subject to the insolvency proceedings in the manner established by the FRIA.

**Court-Supervised Rehabilitation**

**Types of Proceedings**

**Voluntary Proceedings**

An insolvent debtor (i.e. a sole proprietorship, partnership, or corporation that is generally unable to pay its debts as they fall due in the ordinary course of business or has liabilities that are greater than its assets) may initiate voluntary proceedings under the FRIA by filing a petition for rehabilitation with the Philippine Regional Trial Court which has jurisdiction over the principal office of the debtor, as specified in its articles of incorporation or partnership or, in cases of sole proprietorships, in its registration papers with the Department of Trade and Industry. A group of debtors may also jointly file a petition for rehabilitation when one or more of its members foresee the impossibility of meeting debts as they fall due, and the financial distress would likely adversely affect the financial condition or operations of the other members of the group or the participation of the other members of the group is essential under the terms and conditions of the proposed rehabilitation plan.

**Involuntary Proceedings**

Any creditor, or group of creditors, with a claim of, or the aggregate of whose claims is, at least PHP 1,000,000 (approximately USD 21,267.78 at an exchange rate of USD 1 = PHP 47.02), or at least 25% of the subscribed capital stock or partners’ contributions, whichever is higher, may initiate involuntary proceedings against the debtor by filing a petition for rehabilitation with the court if:

- There is no genuine issue of fact or law with respect to the claim(s) of the petitioner(s), and either the due and demandable payments thereon have not been made for at least 60 days or the debtor has failed generally to meet its liabilities as they fall due; or

- A creditor, other than the petitioner(s), has initiated foreclosure proceedings against the debtor that will prevent the debtor from paying its debts as they become due or will render it insolvent.
Action on the Petition and Commencement of Proceedings

If the court finds the petition sufficient in form and substance, it will, not later than five working days from the filing of the petition, issue a Commencement Order which, among other things: (i) declares that the debtor is under rehabilitation; (ii) appoints a Rehabilitation Receiver; (iii) prohibits the debtor from selling, encumbering, transferring, or in any manner disposing of, any of its properties, except in the ordinary course of business; (iv) prohibits the debtor from making any payment of its liabilities outstanding as of the date of filing of the petition; (v) prohibits the debtor’s suppliers of goods or services from withholding the supply of goods and services in the ordinary course of business for as long as the debtor makes payments for the services and goods supplied after the issuance of the Commencement Order; (vi) authorises the payment of administrative expenses as they become due; (vii) suspends all actions or proceedings, in court or otherwise, for the enforcement of claims against the debtor; (viii) suspends all actions to enforce any judgment, attachment or other provisional remedies against the debtor; (ix) sets an initial hearing on the petition; and (x) directs all creditors and interested parties to file their claims at least five days before the initial hearing.

If, within the same period, the court finds the petition deficient in form or substance, it may, in its discretion, give the petitioner/s not more than five working days from receipt of the notice of the order of the court to amend or supplement the petition, or to submit such documents as may be necessary to put the petition in proper order. If the deficiency is not corrected within the extended five-day period, the court must dismiss the petition.

Upon issuance of the Commencement Order and until the approval of the Rehabilitation Plan or dismissal of the petition, whichever is earlier, the imposition of all taxes and fees, including penalties, interests and charges thereof, due to the national government or to local government units will be considered waived, in furtherance of the objectives of rehabilitation.

Under the FRIA, the “commencement date” refers to the date on which the court issues the Commencement Order, which shall be retroactive to the date of filing of the petition for both voluntary and involuntary proceedings.

Effectivity and Duration of Commencement Order

Unless lifted by the court, or where the rehabilitation plan is seasonably confirmed or approved, or the rehabilitation proceedings are ordered terminated by the court, the Commencement Order, including the stay of actions and proceedings for the enforcement of claims, will remain effective for the duration of the rehabilitation proceedings for as long as there is a substantial likelihood that the debtor will be successfully rehabilitated. However, the order suspending any pending execution against the individual debtor lapses after three months have passed without a proposed agreement being accepted by the creditors, or as soon as such agreement is denied.

Court Proceedings

If, after the initial hearing on the petition for rehabilitation, the court is satisfied that there is merit in the petition, it will refer the petition to the Rehabilitation Receiver. The Rehabilitation Receiver will evaluate the rehabilitation plan and submit his recommendations to the court within a period of not more than 90 days. However, the court may also refer any dispute relating to the Rehabilitation Plan or the rehabilitation proceedings to arbitration or other modes of dispute resolution.

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7 The issuance of a Stay or Suspension Order also prohibits the debtor from selling, encumbering, transferring or disposing of any of its properties except in the ordinary course of business and from making any payment of its outstanding liabilities as of commencement date. However, it does not affect the right to commence actions or proceedings in order to preserve ad cautelam a claim against the debtor and to toll the running of the prescriptive period to file the claim.
If the petition is dismissed because of a finding that: (i) the debtor is not insolvent; (ii) the petition is a sham filing intended only to delay the enforcement of the rights of the creditor(s) or of any group of creditors; (iii) the petition, the Rehabilitation Plan and the attachments thereto contain materially false or misleading statements; or (iv) the debtor has committed acts of misrepresentation or in fraud of its creditor(s) or a group of creditors, then the court may order the petitioner to pay damages to any creditor or to the debtor, as the case may be, who may have been injured by the filing of the petition, to the extent of any such injury.

The court may also convert the proceedings into one for the liquidation of the debtor upon a finding that: (a) the debtor is insolvent; (b) there is no substantial likelihood for the debtor to be successfully rehabilitated as determined in accordance with the rules promulgated by the Supreme Court; and (c) there is a failure of rehabilitation.

The court may also convert the proceedings into liquidation: (i) upon motion of the debtor (juridical debtor) at any time during the pendency of court-supervised or pre-negotiated rehabilitation proceedings; (ii) when no rehabilitation plan is confirmed within one year from the date of filing of the petition to confirm a rehabilitation plan; (iii) in cases of termination of proceedings, due to failure of rehabilitation or dismissal of petition for reasons other than technical grounds; or (iv) upon verified motion of three or more creditors whose claims total at least either PHP 1,000,000 (approximately USD 21,226.78 at an exchange rate of USD 1 = PHP 47.02) or constitute at least 25% of the subscribed capital or partners’ contributions, whichever is higher.

Management of the Juridical Debtor

Unless otherwise ordered by the court upon motion of any interested party, the management of the juridical debtor will remain with the existing management subject to the applicable laws and agreements, if any, on the election or appointment of directors, managers or managing partner. However, all disbursements, payments or sale, disposal, assignment, transfer or encumbrance of property, or any other act affecting title to or interests in property, will be subject to the approval of the rehabilitation receiver and/or the court.

Clawback Provisions

The court may, upon motion and after notice and hearing, rescind or declare as null and void any sale, payment, transfer or conveyance of the debtor’s unencumbered property or any encumbering thereof by the debtor or its agents or representatives after the commencement date which are not in the ordinary course of the business of the debtor.

The court may also rescind or declare as null and void any transaction that occurred prior to the commencement date and was entered into by the debtor or involved its funds or assets, on the ground that the same was executed with intent to defraud a creditor(s) or constitutes undue preference of creditors.

Other Salient Provisions of the FRIA

• Under the FRIA, obligations incurred after the commencement date to finance the rehabilitation of the debtor are considered administrative expenses. Thus, these obligations can be paid in the ordinary course of business during the rehabilitation period and enjoy priority in preference of claims. This provision improves creditor rights for creditors coming in during rehabilitation. By way of comparison, under the Rules on Corporate Rehabilitation, a Stay Order directs the payment of new loans or other forms of credit accommodations obtained for the rehabilitation of the debtor only with prior court approval.

• The FRIA also provides tax exemption of forgiven or reduced obligations.
• The compensation of employees required to carry on the business is considered an administrative expense. Claims for salary and separation pay for work performed after the commencement date are also an administrative expense. However, claims of separation pay for months worked prior to the commencement date are considered pre-commencement claims.

• The FRIA provides further clarifications on the treatment of contracts. Under the FRIA – unless cancelled by virtue of a final judgment of a court of competent jurisdiction issued prior to the issuance of the Commencement Order, or at any time thereafter by the court before which the rehabilitation proceedings are pending – all valid and subsisting contracts of the debtor with creditors and other third parties as at the commencement date remain in force, provided that within 90 days following the issuance of the Commencement Order, the debtor, with the written consent of the Rehabilitation Receiver, notifies in writing each contractual counterparty whether or not it is confirming the particular contract. Contractual obligations of the debtor arising or performed during this period, and afterwards for confirmed contracts, are considered administrative expenses. Contracts not confirmed within the required deadline are considered terminated. Claims for actual damages, if any, arising as a result of the election to terminate a contract are considered pre-commencement claims against the debtor, to be filed with the rehabilitation court as a separate claim. The claim will be considered in the rehabilitation plan with the other claims against the debtor. The provisions of the FRIA do not prevent the cancellation or termination of any contract of the debtor for any ground provided by law.

Rehabilitation Plan

Confirmation of the Rehabilitation Plan

If no objections to the Rehabilitation Plan are filed within 20 days from receipt of notice from the court that a Rehabilitation Plan has been submitted to the court, or if the objections filed are found by the court to be lacking in merit or have been cured or have been resolved pursuant to an order to cure issued by the court, then the court must issue an order confirming such Rehabilitation Plan. The court may confirm the Rehabilitation Plan notwithstanding the existence of unresolved disputes over claims if the Rehabilitation Plan has made adequate provisions for paying these claims.

Effect of Confirmation of the Rehabilitation Plan

• The confirmed Rehabilitation Plan will be binding upon the debtor and all persons who may be affected by it, including the creditors, whether or not they participated in the proceedings, whether or not their claims have been included in the schedule and even if they opposed the Rehabilitation Plan;

• The debtor must comply with the provisions of the Rehabilitation Plan and take all actions necessary to carry them out;

• Payments are made to the creditors in accordance with the provisions of the Rehabilitation Plan;

• Contracts and other arrangements between the debtor and its creditors will be deemed as continuing in application but only to the extent that they do not conflict with the provisions of the Rehabilitation Plan;

• Any compromise on amounts or rescheduling of timing of payments by the debtor will be binding on the creditors regardless of the successful implementation of the Rehabilitation Plan; and
Claims arising after approval of the Rehabilitation Plan that are otherwise not treated by the Rehabilitation Plan are not subject to any Suspension Order.

Pre-Negotiated Rehabilitation

An insolvent debtor, by itself or jointly with any of its creditors, may file a verified petition with the court for the approval of a pre-negotiated Rehabilitation Plan, supported by an affidavit showing the written endorsement or approval of creditors holding at least two-thirds of the total liabilities of the debtor, including secured creditors holding more than 50% of the total secured claims of the debtor and unsecured creditors holding more than 50% of the total unsecured claims of the debtor.

Out-of-Court or Informal Restructuring Agreements and Rehabilitation Plans

In addition to the existing court-supervised and pre-negotiated rehabilitation, the FRIA introduces out-of-court rehabilitation or informal restructuring.

Minimum Requirements

The following are the minimum requirements for an out-of-court or informal restructuring/work-out agreement or Rehabilitation Plan (“OCRA”) under the FRIA:

- The debtor must agree to the out-of-court or informal restructuring/work-out agreement or Rehabilitation Plan;
- It must be approved by creditors representing at least 67% of the secured obligations of the debtor;
- It must be approved by creditors representing at least 75% of the unsecured obligations of the debtor; and
- It must be approved by creditors holding at least 85% of the total liabilities, secured and unsecured, of the debtor.

A standstill period, not exceeding 120 days, may be agreed upon by the parties pending negotiation and finalisation of the out-of-court or informal restructuring. The standstill period is effective and enforceable not only against the contracting parties but also against the other creditors, provided that the necessary creditor approval on the standstill period is obtained and notice thereof is published in a newspaper of general circulation once a week for two consecutive weeks.

Cram-down Effect

A restructuring/work-out agreement or Rehabilitation Plan that is approved pursuant to an informal workout framework will have the same legal effect as a court-approved Rehabilitation Plan.

Any court action or other proceeding arising from, or relating to, the out-of-court or informal restructuring shall not stay its implementation, unless the relevant party is able to secure a temporary restraining order or injunctive relief from the Court of Appeals in an original action for a petition for certiorari under Rule 65 of the Philippine Rules of Court.

Regional Trial Courts, however, will have jurisdiction over a petition for court assistance to execute or implement the standstill agreement or the OCRA or a petition for annulment of the standstill agreement or the OCRA.
Liquidation Proceedings (Individuals or Corporations)

In liquidation proceedings, the basic premise is that the debtor does not have enough assets/property to cover his obligations. Liquidation proceedings may be voluntary or involuntary.

Types of Proceedings

Voluntary Liquidation

An insolvent debtor may apply for liquidation by filing a verified petition for liquidation with the court. The petition must establish the insolvency of the debtor, and must contain the following:

- A schedule of the debtor’s debts and liabilities, including a list of creditors with their addresses, amounts of claims and collaterals, or securities, if any;
- An inventory of all of the debtor’s assets, including receivables and claims against third parties; and
- The names of at least three nominees to the position of liquidator.

At any time during the pendency of court-supervised or pre-negotiated rehabilitation proceedings, the debtor may also initiate liquidation proceedings by filing, in the same court where the rehabilitation proceedings are pending, a motion to convert the rehabilitation proceedings into liquidation proceedings.

If the court finds the petition or the motion, as the case may be, to be sufficient in form and substance, the court will issue a Liquidation Order.

Involuntary Liquidation

Three or more creditors of an insolvent corporate debtor whose claims total at least PHP 1,000,000 (approximately USD 21,267.78 at an exchange rate of USD 1 = PHP 47.02) or at least 25% of the subscribed capital stock or partners’ contribution of the debtor, whichever is higher, may seek the liquidation of debtor by filing a petition for liquidation of the debtor with the court.

At any time during the pendency of or after a rehabilitation court-supervised or pre-negotiated rehabilitation proceeding, three or more creditors whose claims are at least either PHP 1,000,000 or at least 25% of the subscribed capital or partners’ contributions, whichever is higher, may also initiate liquidation proceedings by filing a verified motion, in the same court where the rehabilitation proceedings are pending, to convert the rehabilitation proceedings into liquidation proceedings.

If the court determines the petition or motion to be meritorious, it will issue a Liquidation Order.

On the other hand, any creditor or group of creditors with a claim of, or with claims aggregating at least PHP 500,000 (USD 10,633.89 at an exchange rate of USD 1 = PHP 47.02) against an individual debtor may file a verified petition for liquidation with the court of the city or province in which the debtor resides. The court will issue an order requiring the individual debtor to show cause why he should not be declared an insolvent. If the individual debtor defaults or if, after trial, the issues are found in favour of the petitioning creditors, the court will issue the Liquidation Order.
Effects of the Liquidation Order

Upon the issuance of the Liquidation Order:

- The juridical debtor will be deemed dissolved and its corporate or juridical existence terminated;
- Legal title to and control of all the assets of the debtor, except those that may be exempt from execution, will be deemed vested in the liquidator or, pending his election or appointment, with the court;
- All contracts of the debtor will be deemed terminated and/or breached, unless the liquidator, within 90 days from the date of his assumption of office, declares otherwise and the contracting party agrees;
- No separate action for the collection of an unsecured claim will be allowed. Such actions already pending will be transferred to the liquidator to accept and settle or contest. If the liquidator contests or disputes the claim, the court will allow, hear and resolve such contest, except when the case is already on appeal. In such a case, the suit may proceed to judgment, and any final and executory judgment therein for a claim against the debtor will be filed and allowed in court; and
- No foreclosure proceeding will be allowed for a period of 180 days.

Rights of Secured Creditors

The Liquidation Order will not affect the right of a secured creditor to enforce his lien in accordance with the applicable contract or law. A secured creditor may:

- Waive his right under the security or lien, prove his claim in the liquidation proceedings and share in the distribution of the assets of the debtor; or
- Maintain his rights under the security or lien.

If the secured creditor maintains his rights under the security or lien:

- The value of the property may be fixed in a manner agreed upon by the creditor and the liquidator. When the value of the property is less than the claim it secures, the liquidator may convey the property to the secured creditor and the latter will be admitted in the liquidation proceedings as a creditor for the balance. If its value exceeds the claim secured, the liquidator may convey the property to the creditor and waive the debtor’s right of redemption upon receiving the excess from the creditor;
- The liquidator may sell the property and satisfy the secured creditor’s entire claim from the proceeds of the sale; or
- The secured creditor may enforce the lien or foreclose on the property pursuant to applicable laws.

Liquidation Plan

Within three months from assumption into office, the liquidator must submit a Liquidation Plan to the court. The Liquidation Plan must, as a minimum, enumerate all the assets of the debtor and all the claims against the debtor and provide a schedule of liquidation of the assets and payment of the claims.
The liquidator must implement the Liquidation Plan as approved by the court. Payments must be made to the creditors only in accordance with the provisions of the Liquidation Plan. But if the debtor and creditor are mutually debtor and creditor of each other, one debt shall be set off against the other. Should there be any balance, then the balance will be allowed in the liquidation proceedings.

Concurrence and Preference of Credits

The Liquidation Plan must ensure that the concurrence and preference of credits as enumerated in the Civil Code and other relevant laws will be observed, unless a preferred creditor voluntarily waives his preferred right. Credits for services rendered by employees or labourers to the debtor enjoy first preference, unless the claims constitute legal liens under relevant provisions of the Civil Code.

Certain types of credits enjoy preference with respect to specific movable or immovable properties ("special preferred credits").

Among the special preferred credits, taxes and assessments due upon the property to which the claims relate enjoy absolute preference. All the remaining classes of special preferred credits with respect to specific movable or immovable property (e.g. credits secured by a pledge or mortgage) do not enjoy priority among themselves, but must be paid concurrently and pro rata, i.e. in proportion to the amount of the respective credits.

Credits that do not enjoy any preference with respect to specific property are satisfied in the order established in article 2244 of the Civil Code. Article 2244 provides for the preference of certain claims and credits which, without special privilege, appear in either a public instrument (i.e. the instrument is notarised) or a final judgment. These credits have preference among themselves in the order of priority of the dates of the instruments and of the judgments, respectively.

Clawback Provisions

Any transaction occurring prior to the issuance of the Liquidation Order or, in case of the conversion of the rehabilitation proceedings, prior to the commencement date, entered into by the debtor or involving its assets, may be rescinded or declared null and void on the ground that the same was executed with intent to defraud a creditor or creditors or which constitute undue preference of creditors.

The liquidator or, with his conformity, a creditor may initiate and prosecute any action to rescind, or declare null and void, any transaction described in the immediately preceding paragraph.

Cross-Border Insolvency Proceedings

The FRIA provides for recognition of foreign insolvency proceedings and adopts the UNCITRAL Model Law on Cross-Border Insolvency, subject to the FR Rules.

The FR Rules apply when:

- Assistance is sought in a Philippine court by a foreign court or a foreign representative in connection with a foreign proceeding;
- Assistance is sought in a foreign State in connection with a proceeding governed by the FRIA and the FR Rules;
• A foreign proceeding and a proceeding governed by the FRIA and the FR Rules are concurrently taking place; or

• Creditors in a foreign State have an interest in requesting the commencement of, or participating in, a proceeding under the FR Rules for court-supervised rehabilitation, pre-negotiated rehabilitation or OCRA.

Foreign creditors are accorded the same rights as creditors in the Philippines in proceedings involving court-supervised rehabilitation, pre-negotiated rehabilitation and OCRA governed by the FR Rules.

However, courts must refuse to take any action in any cross-border insolvency proceeding where: (i) the action would be manifestly contrary to the public policy of the Philippines; and (ii) the court finds that the country where the foreign rehabilitation proceeding is taking place does not extend recognition to a Philippine rehabilitation proceeding, or that the country of which the petitioner-foreign creditor is a national does not grant the same rights to a Philippine creditor in a manner substantially in accordance with the FR Rules.

Rules of Procedure

Under the FRIA, the Supreme Court is tasked with designating the court or courts that will hear and resolve cases brought under its provisions and to promulgate the rules of pleading, practice and procedure to govern the proceedings.

To this end, the Supreme Court has issued a resolution designating the branches of the various Regional Trial Courts in the country that will try and decide cases previously under the jurisdiction of the Securities and Exchange Commission under PD 902-A, which includes petitions of corporations, partnerships or associations to be declared in the state of suspension of payments. More recently, the Supreme Court has issued another resolution expressly stating that all cases on insolvency and liquidation under the FRIA are cognizable only by the Regional Trial Courts designated as special commercial courts.

The Supreme Court has also issued the FR Rules to implement the FRIA. The FR Rules apply to petitions for rehabilitation of corporations, partnerships, and sole proprietorships filed pursuant to the FRIA. Under the FR Rules, any order issued by the court in a rehabilitation proceeding is immediately executory. A party may file a motion for reconsideration against any order issued by the court prior to the approval of the Rehabilitation Plan, but an order issued after the approval of the Rehabilitation Plan may only be reviewed by a special civil action for certiorari under Rule 65 of the Rules of Court.

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8 Supreme Court Administrative Matter No 00-11-03.
9 Supreme Court OCA Circular No. 11-2016, amending Administrative Matter No. 03-03-03-SC.
Poland

General Comments

The Law on Bankruptcy and Reorganization of 28 February 2003 (Journal of Laws 2009 No. 175, item 1361) (the “Act”) came into force on 1 October 2003. The Act regulates principally all bankruptcy issues, including special procedures concerning the insolvency of banks, insurance companies, bond issuers and – since 2009 – the insolvency of individuals.

The Act provides for two separate types of proceedings related to insolvency of business entities. The bulk of the legislative provisions constitute norms for bankruptcy proceedings conducted against an insolvent business entity. This is supplemented with regulations on Reorganization proceedings initiated by financially troubled business entities and aimed at avoiding insolvency, as well as with regulations on insolvency of individuals.

Purpose of Bankruptcy and Reorganization Proceedings

The general purpose of the Act is to enable the proceedings to be conducted in such a manner that the claims of the creditors would be satisfied to the maximum extent possible, and if reasonable, for the existing company of the debtor to continue to operate.

Capacity to be Declared Bankrupt

“Capacity to be declared bankrupt” means that an entity may be declared bankrupt under the Act. Such capacity to go bankrupt is enjoyed only by those business entities which are individuals, legal persons or organizational units without legal personality yet with legal capacity, conducting business activity on their own behalf or conducting professional activity.

Capacity to be declared bankrupt is also enjoyed by limited liability and joint-stock companies not conducting any business activity whatsoever; partners in commercial partnerships bearing liability for the obligations of the company without limitation with their entire property; and partners in professional partnerships.

Entities which may not be declared bankrupt include the State Treasury, units of territorial self-government and entities created by a legislative act.

Grounds for Bankruptcy

The basic prerequisite for the declaration of bankruptcy is insolvency of the debtor, meaning the debtor’s failure to pay its debts or perform other pecuniary obligations as they fall due.

With respect to legal persons and organizational units without legal personality yet enjoying legal capacity, a distinct prerequisite for the declaration of bankruptcy is excessive indebtedness, meaning that liabilities exceed the value of all the assets of such entity. Under such circumstances, bankruptcy may be declared regardless of whether the debtor is paying its current liabilities.

Bankruptcy Procedures

The basic bankruptcy procedure results in the liquidation of the assets of the debtor ("liquidation bankruptcy"). However, if it is possible that, by means of an arrangement, creditors will be satisfied to a greater extent than as a result of liquidation bankruptcy, the debtor is declared bankrupt with the right to enter into an arrangement ("arrangement bankruptcy"). Both types of bankruptcy differ considerably, as discussed below.
The bankruptcy procedure is determined by the court upon the declaration of bankruptcy. Depending on the circumstances one bankruptcy procedure may be replaced with the other in the course of the proceedings.

**Proceedings Concerning Declaration of Bankruptcy**

Bankruptcy is declared by the district commercial court with jurisdiction over the main business unit of the debtor.

**Bankruptcy Petition**

Bankruptcy proceedings are commenced at the initiative of an entitled entity – primarily the debtor and each of its creditors. Moreover, the following types of entities, as specified by the Act, are entitled to request that bankruptcy be declared with respect to:

- **Commercial partnerships** – each partner responsible without limitation for the liabilities of the partnership;
- **Legal persons and other organizational units without legal personality upon which a separate Act of law confers legal personality** – anyone authorized to represent them individually or jointly with another person;
- **A state enterprise** – its founding body;
- **A sole shareholder of a state Treasury company** – the minister competent for the state Treasury;
- **A legal person or commercial partnership in liquidation** – each liquidator;
- **Legal persons entered in the National Court Register** – a trustee appointed pursuant to article 26, paragraph 1 of the National Court Register Act (in cases where the entity fails to fulfil its statutory obligations of filing certain documents with the Register);
- **A debtor to whom public aid in excess of EUR 100,000 was granted** – the aid-granting entity.

The debtor is obliged, no later than two weeks from the moment the appropriate legal grounds arise, to file a bankruptcy petition with the court. The same time limit is binding on the authorised representatives of legal persons and other organizational units. Those who fail to comply with this obligation are liable to creditors for any losses caused by the failure to comply. Furthermore, persons who fail to comply with the obligations may be prohibited from conducting business activity on their own account for three to ten years, as well as from holding the position of member of supervisory board or representative or proxy in a commercial company, state enterprise, co-operative, foundation or association.

**Decision on Declaration of Bankruptcy**

The court has two months to adjudicate the declaration of bankruptcy.

The court may dismiss the bankruptcy petition if the debtor defaults in the performance of liabilities for no more than three months and outstanding liabilities account for no more than 10% of the balance-sheet value of the debtor’s business. However, the petition may not be dismissed if the failure to perform liabilities is of a permanent nature or if such a dismissal may be detrimental to the creditors.
The court is obliged to dismiss the bankruptcy petition if the assets of the debtor are insufficient to cover the costs of the bankruptcy proceedings. The court may dismiss the petition if the debtor's assets are encumbered to such an extent that they are insufficient to cover the costs of the proceedings.

Accepting the bankruptcy petition, the court issues a decision in which it:

- Specifies the manner of conducting the proceedings (namely, liquidation or arrangement proceedings);
- Specifies the scope and manner of management by the bankrupt entity of its assets in the case of arrangement bankruptcy;
- Calls upon the creditors of the bankrupt entity to file notices of their receivables within a prescribed deadline, no shorter than one month and no longer than three months; and
- Appoints a judge commissioner and a receiver, court supervisor or administrator.

The decision is immediately announced in Monitor Sądowy i Gospodarczy (the "Court and Economic Journal") and in the local newspaper. The date on which the court issues the bankruptcy decision is the bankruptcy date.

The duties of the judge commissioner, appointed in the court decision, include directing the course of actions in the bankruptcy proceedings; supervising the actions of the receiver, court supervisor or administrator; and specifying the actions which may not be taken without the authorisation or approval of the board of creditors.

A receiver is appointed in the case of declaration of liquidation bankruptcy. The receiver is responsible for the administration of the assets of the bankrupt entity and its liquidation. A court supervisor is appointed if arrangement bankruptcy is declared, provided the bankrupt entity has retained the right to manage its own assets. In such a case the supervisor monitors the actions and the business of the bankrupt entity. If the bankrupt entity has been deprived of the right to manage its own assets, an administrator is appointed in order to exercise that right. The administrator takes any actions related to the day-to-day running of the business of the bankrupt entity and keeping the bankruptcy estate in a non-deteriorated condition.

If a bankruptcy petition is filed by a creditor acting in bad faith, the court dismisses the petition and charges the creditor with the costs of the proceedings. The court may order that the creditor make an applicable public statement. The creditor is also obliged to redress the damage caused by its actions.

An appeal regarding the decision of the court declaring bankruptcy may be filed only by the bankrupt entity. A complaint regarding the decision of the court dismissing the petition can only be filed by the petitioner. It is not possible to file a last resort appeal ("kasacja") against the decision of the court of second instance.

**Consequences of Announcing Bankruptcy**

Declaration of bankruptcy gives rise to a number of consequences both for the bankrupt entity itself and its creditors. These consequences affect the bankrupt entity, its assets and liabilities, as well as any pending proceedings, but vary depending on the type of bankruptcy proceedings, i.e., liquidation proceedings or arrangement proceedings.
Consequences for the Bankrupt Entity

In the case of liquidation proceedings the most important consequence for the bankrupt entity is the obligation to disclose and make available to the receiver all of its property together with accompanying documentation. The judge commissioner may issue an order preventing a bankrupt individual or members of the bodies of a bankrupt company from travelling outside of Poland.

In the case of arrangement proceedings the bankrupt entity is under an obligation to provide the judge-commissioner and the court supervisor with all necessary information and also to allow the court supervisor access to all business and accounting records. If the bankrupt entity has been deprived of the right to manage its assets, the above-described regulations relating to liquidation proceedings apply accordingly.

Consequences for the Bankrupt’s Assets and Liabilities

As of the announcement of bankruptcy, the bankrupt entity’s assets (excluding specific assets such as: proceeds acquired out of mortgage or pledge enforcement with respect to which the bankrupt acted as a security trustee up to the value to which the pledgees or mortgagees are entitled; the limited amount of remuneration the bankrupt is entitled to under a labour agreement; or some personal belongings (clothing), a limited number of farm animals, food supplies necessary for the period of one month for the bankrupt and his family, necessary pharmaceuticals used by the bankrupt) become the bankrupt entity’s estate from which the bankrupt entity’s creditors can satisfy their claims.

Following the announcement of liquidation bankruptcy, the bankrupt entity loses the right to manage, use and dispose of those assets that are included in the bankrupt entity’s estate. The receiver administers the bankrupt entity’s estate. Effective as of that moment, the bankrupt’s assets cannot be encumbered with any limited right in property, and limited rights in property cannot be entered in any public registers except for a mortgage, provided that the request to record a mortgage was filed within six months preceding the date of filing the petition for bankruptcy declaration.

In an arrangement bankruptcy the bankrupt administers its estate under supervision of the court-appointed supervisor, provided, however, that the court has not appointed an administrator. If the latter is the case the bankrupt is, in the majority of cases, deprived of the administration of its estate. The court appoints the administrator if the bankrupt does not warrant proper exercise of the administration. The court ex officio revokes the administration by the bankrupt and appoints an administrator in the event that:

- The bankrupt has violated the law, even if without fault, when performing administration; or
- The manner in which the bankrupt exercises administration does not guarantee the implementation of the arrangement.

As a matter of principle, the bankrupt performing administration has the right to perform acts of ordinary administration. The consent of the court supervisor is required for the performance of acts of extraordinary administration, unless the Act requires the consent of the committee of creditors.

The provisions in agreements or contracts which stipulate that in the event of bankruptcy the legal relationship to which the bankrupt entity is a party is to be amended or terminated are legally invalid. Such a legal relationship can only be amended or terminated if such an option is provided for under a specific provision of law.
An announcement of liquidation bankruptcy has far-reaching consequences for the bankrupt entity’s contractual obligations. The following is a non-exhaustive list of the consequences that take effect from the date on which liquidation bankruptcy is announced:

- The bankrupt entity’s monetary liabilities that are not yet due become payable;
- Non-monetary financial liabilities are converted into monetary liabilities that become payable on the date bankruptcy is announced;
- The rules governing offsetting of liabilities are modified;
- Acceptance of offers submitted by the bankrupt entity is not legally valid;
- The retention of ownership title, as stipulated in a sales agreement and agreements on transfer of rights as a security, become legally invalid in relation to the items of assets that have been included in the bankrupt entity’s estate, unless they have been executed in a written form with a certified date;
- Sale, consignment sale, service, agency, free use, loan and lease agreements are modified, or in certain cases are terminated;
- Loan agreements expire with respect to the sums of funds that have not yet been extended to the bankrupt entity;
- Security deposit box agreements expire; bank account agreements and securities account agreements remain in full force and effect.

In the case of an arrangement bankruptcy, the major consequences that take effect on the date on which the arrangement bankruptcy is announced are:

- Modification of the manner in which the offsetting of claims may be performed; and
- Retention of ownership title, as stipulated in a sales agreement and agreements on transfer of rights as a security, becomes legally invalid in relation to the items of assets that have been included in the bankrupt entity’s estate, unless they have been executed in written form with a certified date.

In the event the obligations under a mutual agreement have not yet been performed, the receiver may perform the bankrupt entity’s obligations and demand that the other party to such a mutual agreement perform its obligations; alternatively the receiver may withdraw from the agreement. The other party to such a mutual agreement has the right to request that the receiver decide whether it will withdraw from the agreement or demand the performance of the obligations under the agreement, and the receiver is required to announce its decision within three months from receiving the other party’s request.

Upon consent of the judge-commissioner, the receiver may terminate a leasing agreement under which the bankrupt entity acted as a lessee, within two months from the date of announcement of bankruptcy.

Invalidity of Bankrupt Entity’s Actions

The following actions performed with respect to the bankrupt entity’s assets are legally ineffective against the bankrupt entity:

- Legal actions performed by the bankrupt entity within one year prior to the filing for bankruptcy in relation to any use and/or disposal of the bankrupt entity’s assets, both
for consideration and free of charge, as long as the value of those actions performed by the bankrupt entity was substantially larger than the value of the actions of the counterparty;

- Securing and payment of unmatured debt by the bankrupt entity within two months preceding the date of filing for bankruptcy unless the beneficiary was unaware of there being any grounds for the declaration of bankruptcy;

- Legal actions performed by the bankrupt entity on a fee basis, within six months preceding the date of filing a bankruptcy petition, with the bankrupt entity’s related parties (i.e., in the case of a bankrupt entity being an individual: with his family members; and in the case of a bankrupt entity being a company or a legal person: with its shareholders, commercial representatives or their spouses, its affiliated companies or their shareholders, commercial representatives or their spouses, its parent company or its subsidiary company).

The following may be deemed to be legally ineffective if raised or made with respect to the bankrupt entity’s estate:

- Claims for a certain portion of remuneration of the persons administering the bankrupt entity’s business or performing related services where the amount of such remuneration is grossly overstated and does not relate to the amount of time and effort actually contributed by such persons;

- Encumbering the bankrupt entity’s estate with limited rights in property to secure the debt of another person, if the bankrupt entity was not personally liable for the debt, if such limited rights in property were imposed within one year preceding the date of filing of the petition for bankruptcy declaration, and if in consideration for such encumbrance the bankrupt entity received no advantage or the value of advantage the bankrupt entity received is incommensurably small as compared with the value of the security; in the event the bankrupt entity’s estate was encumbered to secure the debts of the bankrupt entity’s relatives or associated companies, such encumbrance is legally ineffective regardless of the value of the consideration received by the bankrupt entity.

Consequences for Pending Proceedings

Following the declaration of bankruptcy, the bankrupt entity loses its capacity to be a party to pending proceedings involving the assets included in the bankrupt entity’s estate. As of that very moment, such proceedings may only be conducted by, or against, a competent bankruptcy authority or body (receiver, court supervisor or administrator).

Court and administrative enforcement proceedings and proceedings to secure claims are suspended on the date of filing for bankruptcy.

Other Consequences

Commercial proxies’ authorisations granted by the bankrupt entity also expire upon the entity being declared bankrupt.

Bankruptcy Proceedings

Bankruptcy proceedings are conducted after the declaration of bankruptcy before the court that declared the bankruptcy. In the event that the proceedings are initiated in several courts of competent jurisdiction, the court that was the first to have issued the bankruptcy declaration is legally competent to conduct the proceedings.
During the bankruptcy proceedings the bankruptcy bodies perform actions aimed at the establishment of the bankrupt entity’s estate, the drawing up of the list of claims as well as: actions aimed at the liquidation of the bankrupt entity’s estate and the distribution of the funds among the bankrupt entity’s creditors, in the case of liquidation bankruptcy proceedings; or actions aimed at reaching an arrangement agreement with the creditors, in the case of arrangement bankruptcy proceedings.

Drawing up the List of Claims

To be able to participate in bankruptcy proceedings, the bankrupt entity’s creditors should file their claims against the bankrupt with the judge commissioner within the time set in the declaration of bankruptcy. Only claims recorded in public registers are automatically (“ex officio”) placed on such a list. Upon the lapse of the time limit set for notification of claims, the receiver, court supervisor or administrator verifies the claims and draws up a list.

After examining the objections, which may be lodged by the creditors, the judge commissioner approves the list of claims. The list of claims drawn up in accordance with the above-described procedure constitutes the basis for participation in the bankruptcy proceedings; an extract from this list serves as a writ of enforcement against the bankrupt entity upon discontinuance or completion of the bankruptcy proceedings.

Arrangement Agreement between the Bankrupt Entity and Creditors

An arrangement agreement between the bankrupt entity its and creditors may be reached even before the declaration of bankruptcy, during the initial meeting of creditors. In principle, however, arrangement agreements are concluded at a later stage, provided such proceedings allow for such an agreement to be reached. Proposals to conclude an arrangement agreement may be put forward by either the bankrupt entity or the creditor whose bankruptcy petition led to the declaration of bankruptcy. In the case of liquidation bankruptcy proceedings the bankrupt, the receiver and the board of creditors may also put forward proposals to conclude an arrangement agreement.

An arrangement agreement generally covers all claims against the bankrupt entity that arose prior to the date of announcing bankruptcy, save for, inter alia, pension and/or disability and sickness insurance contributions, claims arising out of employment relationships and claims secured by limited rights in property imposed on the bankrupt entity’s assets unless the secured creditor has consented to having them included in the arrangement agreement.

In arrangement bankruptcy proceedings, the creditors may be put into separate groups based on the nature of their claims and interests. In such instances the voting on the final arrangement, upon the decision of the judge commissioner, may be conducted in such groups of creditors.

The terms and conditions of restructuring the bankrupt entity’s liabilities and obligations that are set down in the proposed arrangement agreements should be identical for all the creditors or, if the judge commissioner decides that voting on the arrangement is to take place in groups of creditors, identical for creditors included in the same group, unless the creditor expressly consents to less favourable conditions. More favourable terms and conditions of restructuring may be granted to the creditors with minor claims and to the creditors who extended, or are about to extend, a loan after the declaration of bankruptcy in order to allow for the performance of the arrangement agreement.

The Act does not contain a limited list of methods of restructuring the bankrupt entity’s liabilities and obligations. Among the examples of such methods is the extension of the deadline for performance of liabilities or obligations, consent to repay debts in installments, reduction of debts, conversion of debts into shares, and modification of security.
Arrangement proceedings may also be conducted through the liquidation of the bankrupt entity’s assets, for example by the creditor taking over such assets.

An arrangement agreement is approved by the creditors’ meeting that has to be convened within one month from the approval of the list of claims. The arrangement is adopted, as a matter of principle, if creditors holding jointly at least two-thirds of the total sum of the receivables giving the right to vote are in favour thereof.

The approved arrangement agreement is then submitted for approval to the court. The decision the court issues in that respect is appealable. The execution of the arrangement agreement concludes the bankruptcy proceedings.

The arrangement agreement reached through this procedure is binding upon all the creditors whose claims arose prior to the declaration of bankruptcy, regardless of whether they have filed their claims in the bankruptcy proceedings. This does not apply to the creditors to whom the bankrupt entity intentionally failed to disclose and who did not participate in the proceedings.

In the event that no arrangement agreement is reached, the court discontinues the arrangement bankruptcy proceedings and initiates liquidation proceedings and appoints a receiver. Re-opening of the arrangement bankruptcy proceedings is not possible.

**Liquidation of Bankruptcy Estate and Distribution of Funds of Bankruptcy Estate**

Within one month of the declaration of liquidation bankruptcy, the receiver prepares an inventory of the bankruptcy estate and a plan for its liquidation. The receiver then carries out the liquidation of the bankruptcy estate by way of sale of the entire bankrupt business or an organized part thereof, sale of movable or immovable property, collection of claims from the bankrupt entity’s debtors, and exercise or sale of the bankrupt entity's other rights. If possible, the bankrupt entity's business should be sold as a whole and the purchaser of such a business buys it free from any debts, together with all concessions, permits and allowances, unless a specific provision or an administrative decision on granting thereof provides otherwise.

A business, an immovable or a ship recorded in the register of seagoing ships is sold by public auction pursuant to the provisions of the Code of Civil Procedure. Yet, with leave of the board of creditors, they may be sold by unrestricted sale. Movable property is sold by way of unrestricted sale with the permission of the judge-commissioner, or by public auction pursuant to the provisions of the Code of Civil Procedure.

A pledgee of the registered pledge established on an asset of the bankruptcy estate may satisfy its claims through the takeover of such an asset or through sale by public auction, if the pledge agreement so provides. All creditors whose claims are secured by a limited right in property to an asset included in the bankruptcy estate enjoy the right of priority in being satisfied from the amounts obtained from the liquidation of such assets irrespective of the plan of distribution of the funds of the bankruptcy estate. Any surplus that remains after such claims are satisfied is transferred to the funds in order to be distributed among the other creditors.

The funds of the bankruptcy estate are composed of the amounts obtained from the liquidation of the bankruptcy estate or lease of the bankrupt business. Once the judge-commissioner approves the list of claims, the receiver prepares the plan of distribution of such funds. Then the plan is submitted to the judge-commissioner, who can amend or supplement it. The plan can be objected to within two weeks from the date of its announcement. All objections are examined by the judge-commissioner, whose decision in
this respect can be objected to in the court. If no objections are made against the plan or if, upon the examination of the plan, it has been corrected, the plan is then executed.

The Act provides for five types of claims to be satisfied out of the bankruptcy estate, as follows:

- **Category I** – costs of bankruptcy proceedings, premiums for old age pensions, disability pension and sickness benefits, dues for work, dues generated by acts performed by the receiver or administrator, dues under mutual contracts concluded by the bankrupt entity prior to the declaration of bankruptcy whose performance was demanded by the receiver or administrator, claims generated by the bankrupt entity’s acts carried out with the permission of the court supervisor;

- **Category II** – claims under employment relationships, farmer’s receivables under contracts for delivery of products from their own farms, maintenance or alimony due, and pensions due for causing sickness, incapacity to work, disability or death and receivables due to social insurance pensions for the last two years before the bankruptcy declaration, together with interest and execution costs;

- **Category III** – taxes and other public tributes, and other receivables due to social insurance pensions, together with interest and execution costs;

- **Category IV** – other receivables if they are not subject to satisfaction in Category V, together with interest for the last year prior to the date of declaration of bankruptcy, including contractual damages, costs of trial and execution;

- **Category V** – interest which does not belong to higher categories in the order in which the capital is subject to satisfaction, as well as judicial and administrative penalties and receivables in respect of donations and legacies.

Claims in any given category can be satisfied only after claims in the preceding category are fully satisfied. Generally, if it is not possible to satisfy all claims from a given category, they are satisfied proportionally (pro rata).

The claims from Category I are satisfied by the receiver with the permission of the judge-commissioner as the necessary amounts come into the bankruptcy estate; the claims from other categories are satisfied by distribution of the bankruptcy estate funds. The amounts which have come into the bankruptcy estate are distributed once or several times depending on the course of liquidation of the bankruptcy estate.

The last distribution takes place once the bankruptcy estate has been finally liquidated. Afterwards, the court makes a decision declaring the bankruptcy proceedings completed. This decision is published in Monitor Sądowy i Gospodarczy and in the local press.

### Participation of Creditors in the Bankruptcy Proceedings

The creditors are able to control the course of bankruptcy proceedings through the board of creditors. The board of creditors may be appointed before bankruptcy has been declared, at the first meeting of creditors or after bankruptcy has been declared, either at the request of one-fifth of all the creditors or ex-officio by the judge-commissioner if he deems it necessary. The board of creditors gives its consent to certain acts to be taken with respect to the bankruptcy estate, particularly within the liquidation bankruptcy proceedings, such as:

- Managing the bankrupt entity’s business by the receiver for more than three months from the date of declaration of bankruptcy;
• Approval for the sale of assets separately, not as the entire business as is the rule under the bankruptcy proceedings;

• Sale of rights and claims;

• Contracting loans or credits or charging the bankrupt entity's assets with limited rights in property.

Furthermore, in all the cases provided for in the Act, the creditors may make decisions regarding particular acts taken in bankruptcy proceedings at the creditors’ meetings, for instance in the case of approval of an arrangement with the bankrupt entity.

Cross-border Bankruptcy Proceedings

The issues relating to bankruptcy declared within the EU are regulated by Council Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings. Therefore, bankruptcy declared in an EU country is automatically recognised in Poland.

The Polish Act provides for specific regulations in the scope of bankruptcy proceedings conducted in non-EU countries against a debtor that has its assets within the territory of Poland. In order for such proceedings to be valid under Polish law they must be recognised by a Polish court. Once such foreign bankruptcy proceedings are recognised, all Polish proceedings regarding assets of the bankrupt entity are suspended and the entity loses the right to manage and make dispositions with respect to its assets unless the management of its assets has been assigned to the bankrupt entity as a result of an arrangement bankruptcy having been declared. As a rule, however, the right to manage the bankrupt entity’s assets is vested in a foreign administrator.

Declaration of bankruptcy abroad does not prevent bankruptcy from being declared concurrently in Poland. However, once foreign bankruptcy proceedings are recognised, bankruptcy declared in Poland will relate only to the assets located in Poland.

Reorganization Proceedings in the Event of the Threat of Insolvency

In addition to bankruptcy proceedings, the Act provides for a special procedure if the debtor is threatened by insolvency. This procedure applies solely to those business entities which perform their obligations, but it follows from a reasonable assessment of their economic situation that they will become insolvent in the near future. The course of Reorganization proceedings is monitored by a court supervisor.

The Reorganization proceedings are commenced after the business entity files with the court a relevant declaration accompanied by a Reorganization plan. The business entity then announces this in the Monitor Sądowy i Gospodarczy. The date on which the announcement is made is deemed to be a date on which the Reorganization proceedings are commenced. As of that date:

• Repayment of the business entity’s liabilities is suspended;

• Accrual of interest due from the business entity is suspended;

• The possibility of setting off claims is limited;

• Pending enforcement proceedings and proceedings to secure claims conducted against the business entity are suspended and new proceedings cannot be instituted;
The business entity may not sell or charge its property, other than the assets sold in the course of regular business activity.

The Reorganization plan proposed by the business entity should ensure restoration of the business entity’s ability to be competitive on the market by way of restructuring its liabilities, assets and employment in its business. The Act does not provide a limited list of restructuring methods.

Liabilities are restructured by way of an arrangement concluded at the creditors’ meeting.

The arrangement is voted upon by creditors in accordance with rules similar to those applicable to the arrangement bankruptcy. The arrangement is subject to the court’s approval and the decision of the court can be appealed. The arrangement is binding for all the creditors who were notified about the holding of the meeting during which the arrangement is concluded and for any creditor who informed the court supervisor that it would participate in the meeting if the business entity did not deny that the claim exists. The arrangement covers the claims which the business entity included in the list of claims and which were confirmed by the creditors.

In all matters that are not regulated in the Reorganization proceedings, the relevant provisions relating to the bankruptcy proceedings apply.

**Personal Bankruptcy**

Under the amendment dated 5 December 2008 to the Bankruptcy and Rehabilitation Law of 28 February 2003, which came into force as of 31 March 2009, individuals who are not business entities (consumers) can file a petition for bankruptcy declaration.

Numerous restrictions specify who is able to benefit from the right to personal bankruptcy. A petition for declaration of bankruptcy may be submitted only by the debtor. The debt repayment procedure is long and complicated, and will not save the property of the bankrupt consumer. The court will verify in detail the reasons for the debt and will appoint a receiver to whom the debtor will have to surrender his property. Proceeds from the sale of assets will be used to pay the debtor’s liabilities.

The court sets up an individual repayment plan in relation to debtor’s liabilities not satisfied from proceeds received from the sale of the debtor’s assets. The plan must be performed within a period not exceeding three years (under certain circumstances the period may be extended to four and a half years). However, in an extraordinary situation the court may cancel unsatisfied liabilities without setting up the plan (when it is obvious – in the light of the debtor’s personal situation – that the debtor would not be able to make any payments envisaged in the plan).

The court monitors the debt repayment plan on the basis of annual debt repayment reports submitted by the bankrupt. During the debt repayment plan the debtor is prohibited from taking any actions which can worsen his financial situation. The consumer can make use of personal bankruptcy once every ten years.
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Russia

Overview

Russia has had a series of bankruptcy regulations and laws in place since 1992, which have been subject to regular changes and amendments. Notably, in recent years, a number of important amendments were made to Russia’s bankruptcy laws that altered the circumstances in which a company is obliged to make a bankruptcy filing and introduced two types of insolvency proceedings for natural persons. Some of these amendments are yet to be tested in the courts to ascertain their exact scope.

Bankruptcy law provides for several options including reorganisation and rehabilitation of an insolvent company and debt rescheduling for natural persons as an alternative to liquidation and seizure of property.

Legislation

The insolvency regime for corporations and individuals in Russia consists primarily of the Civil Code and the Federal Law “On Insolvency (Bankruptcy)” N 127-FZ (the “Bankruptcy Law”). In addition, there are extensive rules and regulations adopted by the government, the Ministry of Economic Development and various state bodies, as well as decisions of the Supreme Court, designed to standardise insolvency in practice.

Russia’s insolvency regime generally encourages debtor-friendly reorganisations, although, according to practitioners, the majority of insolvencies in Russia result in liquidations. The 2002 reforms enhanced financial rehabilitation, a type of bankruptcy proceeding akin to a US-like Chapter 11 debtor-in-possession reorganisation proceeding. In addition, corporations can reorganise through either court-approved amicable settlements or external management, where a third-party manager takes control of reorganisation proceedings and the debtor’s operations. Bankruptcy proceedings are subject to the jurisdiction of state commercial courts in case of company and individual entrepreneur insolvencies and courts of general jurisdiction for natural persons not engaged in business. Out-of-court restructurings in Russia are relatively uncommon.

On 28 April 2009 Federal Law No. 73-FZ “On Amendment of Certain Legislative Acts of the Russian Federation” was adopted, which introduces amendments into the Russian bankruptcy legislation. In response to the growing number of bankruptcy cases and suspected instances of asset-stripping prior to and during the bankruptcy process, the legislators broadened the circumstances under which creditors in a bankruptcy can challenge transactions by the debtor or with respect to the debtor’s assets. Those amendments were further refined by Federal Law No. 8-FZ “On Amendment of Certain Legislative Acts of the Russian Federation due to the adoption of the Federal Law “On clearing and clearing activities”, dated 7 February 2011; Federal Law No. 144-FZ “On Amendment of Certain Legislative Acts of the Russian Federation”, dated 28 July 2012; and Federal Law No. 134-FZ “On Amending Certain Legislative Acts of the Russian Federation regarding the Countering of Illegal Financial Transactions”, dated 28 June 2013. The amendments to the Bankruptcy Law introduced a concept of “suspicious transactions”, which include sales or transfers by a bankrupt entity of assets for a below-market value which have taken place within one year prior to bankruptcy having been initiated, and also transfers where the parties are assumed to have known that the intent of the transaction was to prejudice the debtor’s creditors. The amendments also expanded the previous definition of “preferential transactions” relating to the debtor’s existing creditors, which in the first instance will have to be considered by creditors seeking additional security from debtors with respect to a pre-existing debt. The amendments aim to protect creditors’ rights by increasing the liability of the management and other controlling persons of debtors (including credit
organisations) in bankruptcy proceedings and imposing new liability and penalties for credit organisation executives and members of management boards who fail to take action in the event of the insolvency of the credit organisation.


In accordance with the latest practice of the Russian Constitutional Court, it is no longer permissible for tax authorities to strike off from EGRUL (Russia’s Unified State Register of Legal Entities) those non-operating (inactive) entities which are going through bankruptcy proceedings. This decision is perceived as being aimed at protecting creditors’ interests and ensuring their right to receive satisfaction.

Who May Initiate Bankruptcy Proceedings?

A Russian bankruptcy procedure can be initiated by both creditors and debtors. Creditors and employees (both current and former) can file a bankruptcy petition in relation to a debtor after obtaining a court judgment that establishes its claims against such debtor in excess of RUB 300,000 and provided that the debt has been unpaid for more than three months. In relation to debtors that are individuals, the bar is set at RUB 500,000. Bankruptcy proceedings for strategic enterprises and natural monopoly entities can be initiated only if the amount of indebtedness exceeds RUB 1,000,000.

Hence, before bankruptcy proceedings may be initiated, the creditors are forced to make an additional effort of first having their claims established through formal court proceedings by a court judgment that has entered into force (i.e. a statutory period for disputing this judgment at a court of a higher jurisdiction (e.g. court of appeal) has expired). In addition to state courts, claims may be established by arbitration proceedings provided the relevant agreement refers dispute resolution to arbitration.

From 29 January 2015, the tax and customs authorities, as well as credit institutions, are entitled to initiate bankruptcy proceedings against debtors if their debts are at least three months overdue. In relation to these, no court decision acknowledging the debt is required in order to initiate the bankruptcy proceedings. Under current court practice, the term “credit institution” covers not only banks with a Russian licence, but banks with licences under their law of incorporation as well.

The debtor has the right to file a bankruptcy petition if it reasonably believes, based on clear evidence, that it is not capable of performing monetary obligations and/or executing its duty to make mandatory payments when due. The Bankruptcy Law also prescribes the cases in which the debtor is obliged to file a bankruptcy petition. These include:

- Satisfaction of claims of one creditor or several creditors makes it impossible for the debtor to discharge monetary obligations in full to other creditors;
- The debtor’s governing bodies have adopted a decision to file a bankruptcy petition with a court;
- A levy of execution against the debtor’s property will significantly aggravate or discontinue the pursuit of the debtor’s economic activity; and
- The debtor has signs of insolvency and/or signs of insufficiency of property.
For example, if a company is balance-sheet insolvent because its liabilities are more than its assets then there is an obligation to file. Similarly, if the company is cash flow insolvent it must file. In theory even one payment default may trigger the obligation to make a filing and put management at risk if there is a failure to file. However, it does not seem that the relevant obligations are put into practice by the courts. The persons that are obliged to file a bankruptcy petition if they fail to file a petition on time bear subsidiary liability for the losses incurred by the bankrupt entity and creditors.

Bankruptcy Procedures

The Bankruptcy Law envisages four bankruptcy procedures for legal persons:

- Supervision (nabłuđenie);
- Financial rehabilitation (finansovoe ozdorovlenie);
- External management (vneshnee upravlenie); and
- Liquidation (konkursnoe proizvodstvo).

As for natural persons, the Bankruptcy Law provides for two types of procedures:

- Debt rescheduling (restrukturizatsiya dolgov); and
- Seizure of property (realizatsiya imushestva).

The law also stipulates that in any procedure the debtor and bankruptcy creditors can conclude an amicable settlement (mirovoe soglashenie).

Arbitrage Administrator

Each stage of the bankruptcy procedure involves an arbitration insolvency specialist (“arbitrage administrator”) approved by the court to carry out the relevant bankruptcy procedure and exercise authorities established by the Bankruptcy Law. Depending on the particular bankruptcy procedure the Bankruptcy Law refers to the arbitrage administrator as: “temporary receiver” during the supervision stage; “administrative receiver” during the financial rehabilitation stage; “external manager” during the external management stage; “liquidator” during the liquidation stage; and “financial manager” in case of insolvency of natural persons. At each stage of bankruptcy the arbitrage administrator has a different scope of authorities. Bankruptcy of banks has only one stage – liquidation; thus the arbitrage administrator is called liquidator and has the relevant scope of authorities.

According to recent amendments, a debtor may no longer propose a nominee for the arbitrage administrator position, even if the debtor initiates bankruptcy proceedings. Instead, the creditors’ committee is to appoint an arbitrage administrator or self-regulating organisation established in accordance with the guidelines which are to be adopted by the Ministry of Economic Development for the competent court to appoint one if its members. The authority of a bankruptcy manager has recently been expanded to include the right to request and obtain information on managers, controlling persons and data of a classified nature.

Supervision

Supervision (nabļūdenie) is the initial and sine qua non phase of bankruptcy proceedings for legal persons. The idea behind this stage is to identify all of the debtor’s creditors, analyse its financial standing, and make arrangements for a first meeting of creditors to decide on the
subsequent course of action. Although the debtor’s management retains all of its powers, the temporary receiver (as appointed by the court upon a motion from the person having requested the debtor’s bankruptcy) exercises control over their actions. The statutory period prescribed for supervision is seven months, but it often drags out for more than one year under all manner of procedural excuses.

After the commencement of supervision the creditors of the debtor whose monetary claims are due have the right within 30 days to raise their claims against the debtor. These claims, if accompanied with pertinent documents, are accepted and included in the register of creditors’ claims (reestr trebovaniy creditorov) (“the register”) by a decision of a competent court. The creditors that failed to file their claims within the specified term are entitled to file them during other bankruptcy stages.

The consequences of the introduction of supervision are as follows:

- The levy of execution on property is suspended (save for claims of the first and second order of priority (this is described below) on the basis of court enforcement orders dated before the supervision);
- Withdrawal from the debtor’s capital is prohibited;
- Set-off is prohibited if it changes the order of bankruptcy creditors’ priority;
- The allocation of profit is prohibited;
- The power of the management to conclude certain transactions is limited and such transactions must be approved by the temporary receiver;
- The reorganisation of the debtor or the establishment of a new entity, branch or representative office is prohibited;
- All obligations incurred prior to acceptance of the bankruptcy petition by the court are deemed mature but only for the purposes of bankruptcy procedure;
- Enforcement of all writs of execution is suspended; and
- All the proceedings related to collection of debts from a debtor are suspended upon the petition of a creditor.

According to recent amendments, after the supervision stage has commenced, no penalties or any other financial sanctions may be imposed on a debtor for failure to perform its obligations. Instead, the amount claimed by creditors accrues interest in accordance with the refinancing rate set by the Central Bank of Russia (“CBR”).

The management of the debtor must prepare a report on the debtor’s property and provide it to the temporary receiver. At the end of supervision the court may render the following decisions:

- Approval of amicable settlement and termination of the bankruptcy proceedings;
- Introduction of financial rehabilitation;
- Introduction of external management; or
- Introduction of liquidation.
Financial Rehabilitation

What is frequently referred to as a "reorganisation" bankruptcy proceeding in line with Chapter 11 of the US Bankruptcy Code is known in Russian as financial rehabilitation (finansovoe ozdorovlenie) and external management.

During supervision, the debtor company (based on a decision of its shareholders), or third persons in agreement with the debtor, may request the creditors present at the first creditors’ meeting to sanction the introduction of financial rehabilitation. If the creditors vote in favour, the court will resolve to commence the financial rehabilitation. However, the creditors may vote against the introduction of financial rehabilitation and instead opt to proceed to external management or liquidation.

If the first creditors’ meeting votes against financial rehabilitation, the court may still decide to introduce financial rehabilitation if the debtor (or a third party) provides a security for all of the registered claims in the form of a bank guarantee for the claims in the debt repayment schedule. If the first creditors’ meeting fails to make a decision on how the bankruptcy process should proceed within the period of time prescribed by law, the debtor may directly petition the court for the introduction of financial rehabilitation if it (or a third party) provides security (in any form) for all of the registered claims.

Apart from the debtor, a request to introduce financial rehabilitation may be lodged by a third party providing the security discussed above.

The court introduces financial rehabilitation for the period (not exceeding two years) stated in the petition upon introduction of financial rehabilitation. If the claims of all creditors are discharged in full prior to the end of the period established by court, the debtor may petition the court for an early termination of financial rehabilitation and the bankruptcy proceedings in connection with the reinstatement of the debtor’s solvency.

Under article 77 of the Bankruptcy Law, together with filing a petition to initiate financial rehabilitation, the person filing the petition must present:

- A financial rehabilitation plan;
- A debt repayment schedule;
- A list of the debtor’s shareholders which have voted for presenting a petition for the initiation of financial rehabilitation to the creditors’ meeting;
- Information on the security offered by the debtor’s shareholders or a third party for the discharge of all registered claims in accordance with the debt repayment schedule.

The provision of security mentioned above is generally optional, except in the circumstances described in the preceding paragraphs.

After commencement of the financial rehabilitation the court appoints the arbitrage administrator from the candidates proposed by the creditors’ meeting.

The consequences of introduction of financial rehabilitation (article 81 of the Bankruptcy Law) are as follows:

- Injunction measures are terminated;
• In addition to set-off, other forms of the termination of obligations of the debtor are prohibited if this results in a change of priority;

• Contractual penalties stop accruing (save for current payments); only the CBR refinancing rate is applied on creditors’ claims unless a lower amount has been agreed with the bankruptcy creditor;

• Conclusion of certain transactions requires the prior approval of the creditors’ meeting or arbitrage administrator;

• The collection of property under writs of execution is suspended;

• The withdrawal from the debtor’s capital is prohibited;

• Distribution of dividends is banned; and

• Settlements with creditors are made through the debt repayment plan.

The debtor’s activities are subject to certain limitations and some of its powers are transferred to the administrative receiver. Prior approval is required from the receiver for transactions which result in:

• An increase in accounts payable of more than 5% of the total amount of creditors’ claims;

• Sale of the debtor’s assets, except for sale of goods or services in the ordinary course of business;

• A claim or debt assignment; or

• Taking of loans.

The creditors’ meeting exercises a certain level of control over the debtor’s actions. The following transactions must be approved by the creditors’ meeting:

• Sale or purchase of assets with a value exceeding 5% of the value of all assets as per the last balance sheet;

• Receipt and granting of loans (credits), suretyship and guarantees, trust management of debtor’s assets;

• Interested-party transactions; and

• Any transactions, if the total value of monetary claims which arose at the financial rehabilitation stage exceeds 20% of the total value of all claims included in the register.

Financial Rehabilitation Plan

As discussed above, the aim of financial rehabilitation is to restore the debtor company’s solvency and repay its indebtedness in accordance with a debt repayment schedule. In order to achieve this, the debtor (or any other person petitioning for financial rehabilitation) must develop a rehabilitation plan which needs to be consistent with the debt repayment schedule. The financial rehabilitation plan is approved by the majority of the creditors present at the creditors’ meeting. At the creditors’ meeting, the bankruptcy creditor has a number of votes according to the share of the amount of its claim in the total amount of claims.
claims included in the register as of the date of creditors’ meeting. Secured creditors are not entitled to vote during financial rehabilitation and external management unless they waive their right to levy execution on secured property during these stages of the process.

The Bankruptcy Law requires that the financial rehabilitation plan and the debt repayment schedule provide for a complete discharge of all of the creditors’ claims included in the register. Under the financial rehabilitation plan the debtor starts to discharge the claims of the bankruptcy creditors within one month from the commencement of the financial rehabilitation and fully discharges the claims of the first and second priority creditors within six months after commencement of financial rehabilitation. The debt repayment schedule needs to provide for a pro rata repayment of creditors’ claims according to the priority of creditors.

A financial rehabilitation plan may be amended if:

- The debtor fails to satisfy the bankruptcy creditors according to the debt repayment schedule; or
- The amount of claims presented by the creditors during financial rehabilitation and included in the register exceeds by more than 20% the total amount of the creditors’ claims subject to repayment under the debt repayment schedule.

If either of the above occurs, the administrative receiver, debtor’s shareholders or a third party that provided security is entitled (in the second instance, the receiver is obliged) to petition for the amendment of the financial rehabilitation plan with the creditors’ meeting. The creditors’ meeting may accept or reject amendments and also require security, if there are reasonable grounds for considering that further satisfaction of the creditors’ claims will be problematic. If the creditors’ meeting rejects amendments to the financial rehabilitation plan the creditors’ meeting may file a petition with the court for the cancellation of financial rehabilitation and introduction of external management or liquidation.

Under article 83 of the Bankruptcy Law the administrative receiver, among other duties, is obliged to:

- Monitor the implementation of the financial rehabilitation plan and debt repayment schedule;
- Consider reports on the implementation of the debt repayment schedule and the financial rehabilitation plan presented by the debtor and to report to the creditors’ meeting on the progress made;
- Monitor the debtor’s timely performance of the creditors’ claims under current payments;
- Supervise the timely discharge of bankruptcy creditors’ claims; and
- Where the debtor fails to meet its obligations under the debt repayment schedule, levy execution on the security provided under the terms of the financial rehabilitation plan.

Prior to the expiry of financial rehabilitation, the debtor is required to provide a report (and its financials) to the administrative receiver, based on which the receiver prepares its own report on the results of the financial rehabilitation. Based on the results of the financial rehabilitation (first and foremost depending on whether the debtor managed to successfully discharge all registered claims) the court may resolve to either terminate the bankruptcy
proceedings, or proceed with external management, or declare the debtor bankrupt and commence liquidation.

External Management

The objective of external management (внешнее управление) is similar to that of financial rehabilitation, since it is aimed at the restoration of the debtor’s solvency. The main differences in the two procedures are in the much greater involvement of the external manager in the management of the debtor, the availability of extensive reorganisational measures and the preparation of the external management plan solely by the external manager.

This procedure is commenced by the creditors’ meeting and approved by the court. Similar to financial rehabilitation, external management is an optional procedure. The duration of external management may not exceed 18 months and may be extended for an additional six-month period. The court appoints an external manager. Under article 94 of the Bankruptcy Law, the consequences faced by the debtor from the introduction of external management are:

- The debtor’s management loses all authority and all decisions are made by the external manager (save for decisions that require creditors’ meeting approval);
- A moratorium on the satisfaction of bankruptcy creditors’ claims is imposed, save for current claims and claims of first and second priority;
- The external manager is entitled to refuse to fulfil executory contracts in cases where the fulfilment of such contracts prevents the restoration of the debtor’s solvency and/or causes the debtor to incur losses;
- Default interest accrues at the refinancing rate of the CBR (and the contractual rate is ignored); and
- Part of the debtor’s assets are sold pursuant to the external management plan.

The external manager is entitled to manage the debtor’s business. The external manager is accountable to the creditors’ meeting and the court.

The following transactions require approval by the creditors’ meeting:

- Major and interested-party transactions;
- Loans, suretyships or guarantees, claim and debt assignments, sale or purchase of shares of other entities, establishment of trusts; and
- Any transactions if the total value of claims which arose during external management exceeds by 20% the total value of all claims included in the register.

External Management Plan

The external management plan is prepared by the external manager and needs to be presented to the creditors’ meeting no later than one month after the external manager is appointed. The external management plan is adopted in the same way as the financial rehabilitation plan. The creditors and other persons whose interests are adversely affected as a result of the plan may challenge it in the court. The plan can be amended.
The external management plan envisages measures for the restoration of the debtor’s solvency, the terms and procedure for implementing such measures, and expenses towards the implementation thereof. It also envisages a term for the restoration of the debtor’s solvency. If a creditors’ committee was formed, the external management plan may also establish what powers have been delegated to the committee by the creditors’ meeting.

Article 109 of the Bankruptcy Law enumerates possible actions that may be undertaken to restore the debtor’s solvency and which can be included by the external manager in the external management plan, including:

- Establishing strategic objectives of the debtor;
- Closing down unprofitable production facilities;
- Collecting accounts receivable;
- Selling part of the debtor’s property;
- Assigning of claims;
- The debtor’s obligations being discharged by the debtor’s shareholders or a third person(s);
- The charter capital of the debtor being increased through contributions of shareholders and third persons;
- Selling an enterprise of the debtor; and
- Replacing the debtor’s assets, etc.

The main difference between an external management plan and a financial rehabilitation plan is that the latter requires that all of the bankruptcy creditors’ claims are discharged during financial rehabilitation, whilst in external management the first priority is the restoration of the debtor’s solvency and only then discharge of claims of the bankruptcy creditors. Using the external management results, the external manager prepares and submits a report to the court which establishes whether the debtor’s solvency was restored or not. After consideration, the court may resolve to proceed with the satisfaction of creditors’ claims or declare the debtor bankrupt and commence liquidation.

Liquidation

Liquidation (konkursnoe proizvodstvo) is initiated after the debtor is declared bankrupt by the court. The objective of liquidation is the satisfaction of the creditors’ claims to the fullest extent possible, through sale of the debtor’s assets or otherwise. The procedure may be initiated by the creditors’ meeting with court approval or by the court itself. The maximum term for liquidation is six months, with the possibility of extension for an additional six-month period. The procedure is conducted by the liquidator appointed by the court. The consequences of the introduction of liquidation are:

- All creditors’ claims are considered to be due and payable;
- Settlement of claims is performed in accordance with the priority of creditors;
- Contractual default interest stops accruing (save for current payments) and instead the CBR’s refinancing rate is applied;
• The confidentiality and commercial secrecy regime in respect of the debtor’s financial state is terminated;

• Termination of powers of governing bodies and the debtor’s shareholders (save for general meeting and decisions on performance by a third party of the debtor’s obligations);

• Transactions entered into in the six-month period before the filing for bankruptcy and/or upon such filing may be invalidated by the court at the suit of the liquidator or a creditor if such transactions give preference to some of the existing creditors of a debtor in insolvency;

• The liquidator must notify of forthcoming lay-offs within one month of the court decision on liquidation;

• All bank accounts of the debtor, save for one to be used for settlement, are to be closed by the liquidator;

• Performance of the debtor’s obligations upon court writs is suspended;

• All the garnishments laid on the debtor’s property are cancelled; and

• Sale of the assets and assignment of receivables are conducted for the purposes of settlement.

Liquidation ends with the court passing one of the following resolutions:

• Termination of liquidation procedures followed by official liquidation of the debtor;

• Termination of the bankruptcy case due to full satisfaction of all creditors’ claims (no liquidation);

• Approval of an amicable settlement and closing the bankruptcy case; or

• Reverting to external management (provided financial rehabilitation and/or external management have not been introduced previously).

Debt Rescheduling

Debt rescheduling (restrukturizaciya dolgov) can be applied to natural persons to repay their debts over a period of up to three years. The procedure may be initiated by a debtor who contemplates insolvency and is unable to pay debts and/or has insufficient property to pay. A creditor is entitled to file for bankruptcy of a natural person if satisfaction of claims of one creditor makes it impossible for the debtor to discharge monetary obligations in full, which amount to at least RUB 500,000, to other creditors.

A court’s decision that the application for bankruptcy is justified has consequences similar to bankruptcies of companies, namely, the debtor may not perform his or her obligations towards creditors and may not conduct obligatory payments, including payments required by court decisions in force. The court decision also accelerates the maturity of all obligations for purposes of bankruptcy proceedings.

The starting point is the draft debt rescheduling plan, which is to be prepared either by the debtor, or the creditor. In case no draft is presented within two months after the court’s decision on initiation of bankruptcy, the financial manager is to propose seizure of property.
The plan is subject to approval by the first creditors’ meeting by a simple majority. If the meeting votes in favour, the plan is to be approved by the court. The court can enforce the rescheduling plan even if it is not approved by the creditors’ meeting, provided that the court finds that the rescheduling will satisfy substantially more claims (at least 50% of registered claims) than immediate seizure of property.

The rescheduling is terminated by virtue of a court decision if all claims have been satisfied. Should not all claims be satisfied, the creditors may file a motion with the court to cancel the debt rescheduling plan not later than 14 days before the end of the period provided for repayment.

Seizure of Property

A competent court is to initiate seizure of property (realizaciya imushestva) in the following cases:

- the debtor and the creditors have not proposed a draft debt rescheduling plan;
- the creditors’ meeting has not approved the draft debt rescheduling plan and the plan has not been given effect by the court; and
- the debt rescheduling plan has been cancelled.

The seizure of property procedure is to be conducted within six months, but the term may be extended by the court. Only the financial manager is entitled to exercise any rights over the debtor’s property, and his mission is to appraise the property in the bankruptcy estate and sell it.

A debtor is discharged from his obligations after the seizure has been completed, unless one of the following conditions has been satisfied:

- the debtor has been found criminally or administratively liable for illegal actions in the course of the bankruptcy proceedings;
- the debtor knowingly provided incomplete or false information;
- the debtor acted in breach of the law when a creditor’s claim arose or during its performance; or
- the debtor has been declared bankrupt within five years after the previous bankruptcy.

A natural person may not file for voluntary insolvency within five years after bankruptcy. He is also barred from managing legal persons within three years after bankruptcy and is obliged, during the five years after bankruptcy, to notify a creditor under a credit or loan agreement of the fact that he has been declared bankrupt.

Amicable Settlement

An amicable settlement (mirovoe soglashenie) may be concluded at any stage of the bankruptcy of a legal or natural person. The creditors’ meeting is entitled to conclude the settlement agreement, approving it by a majority of votes of the bankruptcy creditors present at the meeting. The settlement agreement comes into force immediately upon its approval by the court. An amicable settlement agreement is binding for the debtor, bankruptcy creditors and authorised state bodies, as well as for third parties participating in the settlement agreement, i.e. parties not involved in the bankruptcy procedure itself (for example, these
can be the debtor’s investors discharging the debtor’s obligations to creditors or persons/legal entities providing security).

In case of a breach of the settlement agreement, the size of creditors’ claims is determined on the basis of the settlement agreement, even if the debtor’s breach of the settlement agreement leads to commencement of the bankruptcy case anew (resumption of a bankruptcy case terminated as a result of settlement is not allowed).

According to the statistics published by the Supreme Arbitrazh Court of the Russian Federation, the courts tried 108,451 bankruptcy cases in the period from 2010 through the first half of 2013. Only in 332 cases was financial rehabilitation introduced and of those only 17 were terminated due to full satisfaction of the creditors’ claims. The absolute majority of cases were resolved through liquidation, and 1,465 cases were terminated through amicable settlements.

Priority of Claims

Satisfaction of the creditors’ claims according to priority is possible only during the liquidation or seizure of property stages of bankruptcy and in some cases during external management. In order to participate in allocation of debtor’s property the claims of the bankruptcy creditors shall be included in the register indicating the amount of the claim, type of creditor (secured or unsecured) and grounds of the claim. Qualifying claims are included in the register by the arbitrage administrator. After commencement of the liquidation the bankruptcy creditors are eligible to receive satisfaction of their claims according to the priority set out in the Bankruptcy Law. The Bankruptcy Law provides for the following order of priorities for satisfaction of creditors’ claims:

Payments Outside the Ranking List

Current expenses, which are monetary obligations that arise after the application for bankruptcy has been filed with the court, such as court expenses and bankruptcy manager expenses, have priority over the claims of all other creditors. As such, current payments are to be satisfied before all others.

In the event that the winding-up (cessation) of the activities of a debtor causes or may cause an industrial or ecological disaster, or human casualties, expenses for avoiding such consequences are settled at the same level of priority as the current payments, that is when these expenses become due and prior to any other payments.

Article 134 of the Bankruptcy Law ranks current payments in the following order:

- Court expenses, bankruptcy-manager remuneration and expenses associated with engaging other persons whose participation is mandatory under the Bankruptcy Law;
- Claims regarding salaries and severance pay;
- Expenses associated with the engagement of persons whose participation in the bankruptcy proceedings is not mandatory;
- Utility and maintenance charges; and
- Other current payments.
Payments within the Ranking List

In respect of claims of the bankruptcy creditors, the Bankruptcy Law establishes the following order of priority:

- **First priority (Article 135):** personal tort claims, including compensation for pain and suffering;

- **Second Priority (Article 136):** claims for severance pay, outstanding wages and authors' royalties. Among such, claims of employees regarding their salaries and severance payments in the amount of RUB 30,000 per month per person are to be settled first, followed by the remaining claims of employees regarding their salaries and severance payments. Should any property remain after that, royalties to the authors of intellectual property items become subject to payment;

- **Third Priority (Article 137):** claims of all other creditors, including, specifically:
  
  - Claims arising out of violation of environmental legislation;
  - Claims of mandatory payments;
  - Secured creditors’ claims (i.e. to the extent the creditors were unable to receive a full satisfaction under any security arrangements established to secure their claims against the debtor);
  - Unsecured creditors; and
  - Creditors whose claims arose from challenged suspicious or preferential transactions.

The Bankruptcy Law does not prescribe ranking of claims within one priority. Claims from creditors in any category may only be met once those from creditors in the higher category have been fully granted. Should it be impossible to satisfy claims in full, the claims of the same priority are met on a pro rata basis.

Shareholders of the debtor are not considered creditors of the debtor. If all claims of the bankruptcy creditors are discharged, shareholders are entitled to share proportionally in the debtor’s remaining property.

The claims of third-priority creditors for compensation of losses in the form of lost advantage, collection of fines and penalties and other financial sanctions – in particular, those imposed for a default on or improper performance of the duty to make mandatory payments – are recorded separately in the register and paid after the payment of principal debt and accrued interest.

Treatment of Secured Bankruptcy Creditors

During financial rehabilitation or external management of the debtor, foreclosure for pledge is possible on those goods that are not needed by the debtor for becoming solvent again.

In case execution has not taken place when the debtor has been declared bankrupt, such assets are sold at a public auction in the course of liquidation. In this case, 70% of the proceeds (or 80%, if the underlying obligation secured by the pledge is a loan) is used to discharge the pledgor’s respective secured obligations (regardless of any claims filed by creditors of other priority categories), 20% is directed towards satisfying the claims of
creditors of first and second priority, while 10% is used to cover court and other costs (in the case of a loan, 15% and 5%, respectively).

For natural persons, 80% of the proceeds is used to discharge the pledgor’s secured obligations, with 10% directed towards satisfying the claims of creditors of first and second priority and the remaining 10% towards covering court and other costs.

Written consent of a secured creditor must be obtained if the pledged assets are on sale together with other assets.

In 2015, the capacity of secured creditors to vote at creditors’ meetings was expanded. Previously, secured creditors were allowed to vote during the supervision stage and during the financial rehabilitation stage or external management stage, provided that they do not levy execution over the pledged property. Now, secured creditors are also entitled to vote on matters of election of a bankruptcy manager, or filing for dismissal of the bankruptcy manager, as well as a right to vote on any matters during debt rescheduling or seizure of property of natural persons.

Avoidable Transactions

The Bankruptcy Law also prescribes special regulation of the transactions entered into prior to the commencement of the bankruptcy case or during bankruptcy proceedings. Most of these rules were introduced on 28 April 2009 by Federal Law No. 73-FZ “On Amendment of Certain Legislative Acts of the Russian Federation”. They have been further refined several times, most recently by Federal Law No. 476-FZ “On Amendment of Certain Legislative Acts of the Russian Federation”, dated 29 December 2014. It should be noted that as these applications are relatively recent the court practice is still undeveloped and some of the provisions need to be clarified.

The amendments, which broaden the circumstances under which bankruptcy creditors can challenge transactions by the debtor or with respect to the debtor’s assets, were adopted in response to the growing number of bankruptcy cases and suspected instances of asset stripping prior to and during the bankruptcy process. Previously under the Bankruptcy Law, transactions were generally reversible by the court in favour of creditors if they had occurred within six months prior to bankruptcy, in the case of the transactions providing preference to one creditor over other creditors, and within a one-year limitation period in case of transactions with an interested party.

Challenging Transactions during Bankruptcy

The 2009 amendments to the Bankruptcy Law introduced a new chapter which sets the rules for challenging transactions in bankruptcy procedures. Such transactions may be challenged as suspicious, deemed to infringe creditors’ rights, or preferential.

The changes adopted in 2014 have extended the scope of persons entitled to challenge transactions beyond only arbitrage administrators. Now, a bankruptcy creditor with more than 10% of the total bankruptcy claims in the register of claims is also entitled to apply for avoidance of transactions.

Suspicious Transactions (Article 61.2 of the Bankruptcy Law)

The amendments to the Bankruptcy Law introduce a new concept of “suspicious transactions”, which may be challenged during bankruptcy proceedings. Two types of transactions are defined as suspicious, namely undervalue transactions and transactions which are deemed to infringe the rights of the debtor’s creditors.
An undervalue transaction can be overturned by the court in bankruptcy proceedings if it is proven that:

- The counterparty to such transaction provides incommensurate consideration to the debtor; and
- The transaction is concluded within one year prior to, or after the initiation of, bankruptcy proceedings against the debtor.

Consideration will be deemed incommensurate where a materially lower price is paid to the debtor or when other conditions of the transaction are materially worse for the debtor, when compared with analogous transactions concluded in similar circumstances. The Bankruptcy Law gives as an example the sale of property at a price substantially lower than the market price.

A transaction which is deemed to infringe creditors’ rights may be challenged if the following conditions are simultaneously met:

- The conclusion of the transaction was intended to prejudice creditors’ rights and has resulted in such infringement;
- The counterparty to the transaction was aware or should have been aware of the aim of such transaction; and
- The transaction was concluded within three years prior to, or after the initiation of, bankruptcy proceedings against the debtor.

The concept of the infringement of creditors’ rights is defined by the Bankruptcy Law as any reduction in the debtor’s assets or any increase in the value of the claims against the debtor or any other consequences of the debtor’s transactions or actions which result in the inability by creditors to obtain satisfaction of their claims.

According to the Bankruptcy Law, it is assumed that a transaction was concluded with the purpose of infringing creditors’ rights if at the time of its conclusion the debtor was insolvent and:

- The transaction was gratuitous;
- The transaction was entered into with an interested party;
- The transaction aimed at the repayment by the debtor of capital to a participant;
- The amount of the debtor’s assets alienated under such transaction equals more than 20% of the balance sheet value of its assets (or more than 10% for banks);
- The debtor changed its address without notifying its creditors before or immediately after the conclusion of such transaction, or concealed its property or destroyed or falsified title documents or accounting statements of the debtor; or
- After the conclusion of such transaction, the debtor continued to own and use the property alienated under such transaction or to give orders to the owner regarding the disposal of such property.
Preferential Transactions (Article 61.3 of the Bankruptcy Law)

The Bankruptcy Law clarifies what particular transactions may give preference to one creditor over other creditors for the purpose of challenging them during bankruptcy proceedings. A transaction gives preference to an existing creditor if such transaction:

• Provides for security to an existing creditor;
• Entails any change of priorities in which the existing creditors’ claims are satisfied;
• May entail satisfaction of claims that have not yet matured; or
• Results in preferential satisfaction of claims of one creditor over other creditors’ claims.

The transaction can be invalidated if it was concluded after the court accepted the bankruptcy petition or within one month prior to acceptance of the bankruptcy petition by the court. The transaction can be also invalidated if it was concluded within six months prior to acceptance of the bankruptcy petition by the court, provided that it meets the criteria specified above and it is established that the counterparty was aware of the insolvency signs or insufficiency of property. For instance, currently there is a dispute in which an insolvency receiver is requesting the return of money that was transferred from the account of a bank which had been in a financial crisis, and courts have unanimously confirmed that the money in question needs to be returned.

Actions that may be Challenged

The rules on challenging transactions of the debtor apply not only to civil law transactions (e.g. contracts) concluded by the debtor, but also to any actions relating to obligations arising from civil, labour, family, tax, customs, or court procedural legislation. According to the Decree of the Plenum of the Supreme Arbitrazh Court of the Russian Federation No. 63 “On certain questions related to application of Chapter III.1 of Federal law ‘On insolvency (bankruptcy)’”, dated 23 December 2010, the actions that can be challenged in bankruptcy include specifically:

• Fulfilment of obligations under civil law contracts, including cash or non-cash payments and transfer of property;
• Bank transactions;
• Payment of wages;
• Marital agreements and agreements on the division of marital property;
• Tax payments;
• Execution of court decisions, including amicable settlements; and
• Transfer to the claimant in the final process of cash proceeds from the sale of property of the debtor.

Thus, the Bankruptcy Law permits almost any action of the debtor that meets the criteria of a suspicious or preferential transaction to be challenged.

The Bankruptcy Law sets specific rules for challenging certain transactions. Transactions concluded in the course of organised trade on the basis of at least one bid addressed to an
indefinite circle of trading participants, as well as actions aimed at the fulfilment of the obligations and duties resulting from such transactions, may not be challenged as suspicious or preferential transactions. Transfers of property and assumptions of obligations which are made in the normal course of business may not be challenged as constituting an incommensurate consideration or preferential transaction, if the price of the property transferred under such a transaction (or several related transactions), or the amount of assumed obligations, does not exceed 1% of the value of the debtor’s assets. The debtor’s transactions aimed at fulfilling obligations in respect of which the debtor received immediate commensurate consideration may be challenged only on the basis of possible infringement of creditors’ rights.

Consequences of Invalidation (Article 61.6 of the Bankruptcy Law)

Suspicious and preferential transactions may be challenged during external management or liquidation by the external manager or liquidator at their own initiative or at the request of the creditors’ committee or the creditors’ meeting. If a transaction is invalidated under these grounds, the court will apply reciprocal restitution and all assets transferred under such transaction will be returned to the debtor and form part of its bankruptcy estate. The claims of the counterparty under an invalidated transaction which is deemed to infringe the creditors’ rights and certain types of preferential transactions may only be satisfied after satisfaction of all claims of creditors of all priorities. Claims of recipients of invalidated undervalue transactions may be satisfied in the third priority together with other unsecured claims of the creditors. Generally, suspicious and preferential transactions can be challenged within one year of the date on which the plaintiff learned or should have learned about the grounds for declaring the transaction invalid.

Liability of Controlling Persons

Article 10 of the Bankruptcy Law (as amended on 28 June 2013) covers the question of directors’ liability, introducing a general rule that chief executive officers are personally liable to the debtor for any loss incurred as a result of violations of the Bankruptcy Law. Furthermore, the article specifies several obligations that give rise to liability if they are violated.

The Bankruptcy Law requires the chief executive officer of a non-bank debtor to petition the court to initiate bankruptcy proceedings if the amount of the debtor’s debts exceeds the value of its assets or if the debtor fails to make payments because it has insufficient funds. The chief executive officer must file a bankruptcy petition within one month of the occurrence of either of these events. If the chief executive officer fails to do so, he bears secondary (subsidiary) liability for the debtor’s debts which arise after the date on which the chief executive officer should have filed the petition. Conversely, if the chief executive officer files for insolvency while the debtor is capable of satisfying all creditors’ claims in full, he becomes liable for any possible loss incurred by creditors as a result of such unnecessary filing.

In addition to this, the Bankruptcy Law establishes the liability of a controlling person. The concept of a controlling person is broadly defined as a person (an individual or legal entity) who can control the debtor’s activity and give mandatory instructions to it or who could have done so within a period of two years prior to the initiation of bankruptcy proceedings in relation to the debtor. If a controlling person infringed the rights of the debtor’s creditors by its actions or instructions to the debtor, such controlling person may bear subsidiary liability for monetary obligations of the debtor if the debtor’s assets are insufficient to satisfy all the creditors’ claims. Until proven otherwise, it is assumed that the debtor is bankrupt due to the actions and/or absence of action of the controlling person if one the following circumstances exists:
• The property rights of creditors have been violated as a result of the conclusion or approval of transaction(s) of the debtor by or for the benefit of the controlling person; or

• The debtor’s accounting statements have been lost or falsified prior to the initiation of bankruptcy proceedings. This provision is applicable to the managers who have obligation to organise the bookkeeping and storage of accounting or other reporting documents of the debtor.

The amount of such liability may be reduced if the controlling person proves that the creditors’ losses are significantly less than their claims against the debtor. Infringement of creditors’ rights is considered to have occurred in circumstances where: the value of the debtor’s assets has decreased; the claims against the debtor have increased; or the creditors have failed to receive full or partial satisfaction of their claims as a result of the debtor’s actions.

Corresponding provisions can be also found in Federal Law No. 40-FZ “On the Insolvency (Bankruptcy) of Credit Institutions”, dated 25 February 1999 (as amended). The law provides that, if in relation to a bank there is evidence of insolvency, the management and shareholders of the bank must act to liquidate it. The measures to restore a bank’s solvency (bankruptcy prevention measures) are not available at this stage. Insolvency of a bank is evident if: (i) it is unable to satisfy the claims of its creditors within 14 days after their due date; (ii) the value of its assets is insufficient to perform its obligations to its creditors; or (iii) its capital adequacy ratio falls below 2% (usually 10% if the bank is solvent).

Within 10 days after the occurrence of any of the above events or circumstances, the chief executive officer and the management board of the bank must notify its board of directors and the CBR. The directors must convene a shareholders’ meeting or apply to the CBR with a request to revoke the banking licence of the bank. If the shareholders fail to adopt the decision to liquidate the bank, the directors of the bank are obliged, within three days of the shareholders’ meeting, to apply to the CBR to revoke the bank’s banking licence.

If the chief executive officer, members of the management board, directors or shareholders of a bank fail to liquidate the bank in the circumstances described above, Russian law imposes upon them joint and several secondary (subsidiary) liability for the debts of the bank that arise after the insolvency of the bank becomes evident.

If the shareholders’ meeting that was convened to decide on the bank’s liquidation does not approve the liquidation, an individual shareholder can be absolved from the liability if it: (i) owns (together with its affiliates) less than 10% of the voting shares of the bank; (ii) voted for the liquidation of the bank; or (iii) was not properly notified of the shareholders’ meeting.

If the accounting or other reporting documents of a non-bank debtor are missing or fail to contain, or contain falsified, information on the debtor’s assets and liabilities, the Bankruptcy Law imposes on the chief executive officer secondary (subsidiary) liability for the non-bank debtor’s debts. In contrast, in relation to a bank debtor, the managers having the obligation to secure the safekeeping of the bank’s documents bear secondary (subsidiary) liability for the bank’s debts if the accounting and other reporting documents of that bank debtor are missing.

If the accounting or other reporting documents of a bank debtor are missing or fail to contain, or contain falsified, information on the bank debtor’s assets and liabilities, the Law on Insolvency (Bankruptcy) of Credit Institutions imposes secondary (subsidiary) liability on the managers having the obligation to secure the safekeeping of the bank’s documents. Chief executive officers can also bear criminal and administrative liability for fraudulent activities.
Article 195 of the Russian Criminal Code stipulates that chief executive officers committing fraud during insolvency proceedings or during the period when insolvency was foreseen can be sentenced to up to three years in prison. Section 2 of the same article provides that preferential satisfaction of creditors’ claims can be punished by imprisonment for up to one year. Section 2 can also be applied to a creditor who accepts such preferential satisfaction. Article 196 of the Criminal Code provides liability for premeditated insolvency. The objective aspect of this crime includes any actions of the chief executive officer or a shareholder of a legal entity that consciously led to the insolvency of such entity. Any such actions that result in major damage can be punished by imprisonment for up to six years, possibly with an additional penalty of up to RUB 200,000 or of the amount of the violator’s salary or any other income for a period of 18 months. Finally, article 197 (fraudulent insolvency) of the Criminal Code states that a patently false statement of the chief executive officer or a shareholder that concerns the insolvency of a legal entity and causes major damage is punishable by imprisonment for up to six years, possibly with a fine of up to RUB 80,000 or of the amount of the violator’s salary or any other income for a period of six months. Damage is considered to be “major” when its monetary value amounts to RUB 1,500,000 or more.

The Code of Administrative Offices of the Russian Federation also imposes fines and other penalties for the actions of chief executive officers and shareholder mentioned above (articles 14.12 and 14.13) in case such actions resulted in lesser damages.

In addition, debtors experiencing financial difficulties are restricted by rules applicable to the challenging of transactions concluded prior to bankruptcy during the relevant suspect periods.

Therefore, Russian legislation provides a stringent set of rules and restrictions which must be followed by chief executive officers and shareholders in case their companies are experiencing difficulties. However, not all of those measures are often applied in practice. There have been only a few cases in the courts’ practice (most initiated in respect of banks’ management) in which the management was found guilty for conducting the fraudulent actions mentioned above. This is due to several factors. Firstly, it is difficult for courts to establish the date when insolvency became foreseeable, and in order to hold a person liable it needs to be proven that such person was aware or should have been aware of such circumstances. Only in exceptional cases have Russian courts given out prison sentences for managers. At the same time, applying pecuniary penalties of the insignificant amounts mentioned above cannot serve as a real deterrent for the managers. Nonetheless, the new rules on subsidiary liability described above may act as a more effective deterrent.

Sections of the Bankruptcy Law providing that company executives can be obligated to compensate losses caused to creditors are also very rarely applied. Given the scale of the average debtor’s monetary obligations, it is unrealistic to expect that a manager can repay them from his own pocket.

According to recent amendments, information on claims against controlling persons for vicarious liability is to be made public through the Uniform Federal Register of Information on Bankruptcy, as is information on subsequent court decisions on such matters.

Cross-border Aspects

The Bankruptcy Law does not regulate cross-border bankruptcy in general. However, the Bankruptcy Law establishes rules on the recognition and enforcement of foreign court decisions on bankruptcy by Russian courts.

The Bankruptcy Law provides that foreign court decisions on matters of bankruptcy are recognised in the Russian Federation in accordance with the international treaties of the
Russian Federation. In the absence of an international agreement, foreign court decisions on matters of bankruptcy are recognised on the basis of reciprocity if federal law does not provide otherwise.

**International Treaties**

Russian is a party to a number of international treaties on the recognition and enforcement of court judgments, although none of these directly deal with matters of bankruptcy. These include the CIS Convention “On Legal Aid in Civil and Family Law Disputes and Criminal Prosecution”, adopted in Minsk on 22 January 1993 (the “Minsk Treaty”), and the CIS Agreement “On Order of Settlement of Disputes related to Economic Activity”, adopted in Kiev on 20 March 1992 (the “Kiev Agreement”).

Under the Minsk Treaty and the Kiev Agreement each signatory state undertook to recognise and enforce court judgments rendered in other signatory states. However, Russian courts tend to apply these treaties only to final decisions rendered by foreign courts. Rulings of foreign courts adopting an injunction are not recognised and enforced in the Russian Federation. A decision is considered final if the dispute has been adjudicated on the merits as a result of a court procedure. Therefore, it is unlikely that interim decisions introducing moratoria would be recognised in Russia. It is more likely that a final decision completing the bankruptcy process would be recognised in Russia.

While considering the case, the Russian court will also take into account the procedural rules of Russian domestic law. Russian law provides for criteria for recognition and enforcement in addition to those of the Minsk Treaty and the Kiev Agreement. For example, the treaties do not provide for the refusal of recognition and enforcement on the ground of incompatibility of the decision with Russian public policy. It is not entirely clear whether these additional rules apply. The practice of the Supreme Arbitrazh Court of the Russian Federation confirms that the public policy test applies whether or not the relevant treaties provide for it. However, there is some conflicting case law in the lower courts.

**Reciprocity**

Russian legislation on bankruptcy provides that foreign court judgments on bankruptcy may also be recognised and enforced based on reciprocity. However, it is quite uncommon for Russian courts to apply the concept of reciprocity.

**Examples of recognition proceedings**

Matters regarding recognition of foreign bankruptcy proceedings very rarely come before the Russian courts. Some cases are briefly described below.

**Supreme Arbitrazh Court of the Russian Federation – Recognition of Ukrainian Bankruptcy**

The courts considered an application to recognise in Russia a Ukrainian court ruling introducing a moratorium on the satisfaction of creditors’ claims. The claimant relied on both the Kiev Agreement and the Minsk Treaty.

The Supreme Arbitrazh Court of the Russian Federation examined whether the Ukrainian ruling is a final court decision declaring the debtor insolvent. The court decided that the Ukrainian ruling was not of a final nature and refused to grant it recognition. The court noted that foreign court acts adopting injunctions are not recognised and enforced in Russia; only final court decisions resolving the dispute on the merits can be recognised and enforced.
Federal Arbitrazh Court for Moscow Circuit – Recognition of US Bankruptcy Injunction Order

The court considered an application to recognise an injunction order issued by a US court in the course of a bankruptcy. The Federal Arbitrazh Court for the Moscow Circuit decided that the injunction order was not a final court decision on the merits of the case and therefore was not subject to recognition and enforcement.

Federal Arbitrazh Court for Moscow Circuit – Recognition of US Bankruptcy Court Decision

The court considered a claim to oblige the respondent to register a transfer of shares on the basis of a decision of the US Bankruptcy Court of the District of Delaware declaring the debtor insolvent and distributing its assets. The court noted that the relevant US decision could be recognised in Russia, but denied the claim because the formalities for share transfer were not complied with.

Supreme Arbitrazh Court of the Russian Federation – Recognition of Danish Bankruptcy

The Supreme Arbitrazh Court of the Russian Federation confirmed the ruling of the Arbitrazh Court for the Saint Petersburg and Leningrad region granting an application to recognise and enforce a decision of a Copenhagen commercial court declaring a Danish company insolvent and appointing a receiver.

UK Court Ruling in Support of Russian Bankruptcy

In a recent, high-profile case, the London-based Chancery Court supported bankruptcy proceedings in Russia by siding with creditors who sought orders for disclosure of the assets of a controlling person of a bankrupt Russian credit institution and a freezing order regarding the assets.

Expected New Legislation

The Russian government is planning to introduce certain amendments to the Russian bankruptcy legislation which would, inter alia, incorporate cross-border bankruptcy provisions along the lines of the UNCITRAL Model Law on Cross-Border Insolvency. It is not entirely clear when these amendments will be adopted since the review of the draft bill has been suspended for further refinement and revision.
Singapore

Overview and Introduction

Given the notable preference of creditors and stakeholders in companies for restructuring as opposed to liquidation, this chapter focuses on the corporate rescue mechanisms available under the Singapore Companies Act to rehabilitate an insolvent company and achieve a better realisation of assets than possible in a liquidation.

The Singapore court has a flexible approach towards these mechanisms, which provides substantial scope for the company and its creditors to work themselves out of insolvency with minimal judicial interference.

Applicable Legislation

The principal legislation governing the insolvency and bankruptcy regimes in Singapore consists of the Companies Act,¹ the Companies (Winding-Up) Rules,² the Companies Regulations,³ the Bankruptcy Act⁴ and the Bankruptcy Rules.⁵

Personal Bankruptcy

The law and procedure on bankruptcy in Singapore are comprehensively laid out in Part VI of the Bankruptcy Act.

Bankruptcy proceedings may be commenced against an individual debtor or a firm. The individual debtor must satisfy one of the following conditions before he may be subject to bankruptcy proceedings in Singapore:

- Is domiciled in Singapore;
- Has property in Singapore; or
- Within a period of one year immediately preceding the date of the bankruptcy application, has been ordinarily resident, or has had a place of residence, in Singapore, or has carried out business in Singapore.

Similarly, a firm, which is defined as an unincorporated body of individuals carrying on business in partnership with a view to profit, must satisfy one of the following conditions:

- At least one of the partners in the firm is domiciled in Singapore, has property in Singapore, or within a period of one year immediately preceding the date of the bankruptcy application, has been ordinarily resident or has had a place of residence in Singapore; or
- The firm has, within a period of one year immediately preceding the date of the bankruptcy application, carried out business in Singapore.

The making of a bankruptcy order vests in the Official Assignee all property belonging to the individual debtor, which property becomes divisible among all his creditors. In the meantime, creditors have no further remedy against the bankrupt in respect of the debt owing, and no

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¹ Companies Act (Chapter 50).
² Companies (Winding-Up) Rules (Chapter 50, Rule 1).
³ Companies Regulation (Chapter 50, Regulation 1).
⁴ Bankruptcy Act (Chapter 20).
⁵ Bankruptcy Act (Chapter 20, Rule 1).
action or proceedings shall proceed or be commenced against the bankrupt. For the purposes of preservation of the bankrupt's property for the fair distribution amongst his creditors, all dispositions of property by the bankrupt from the day the bankruptcy application is made until the day the bankruptcy order is made are void, except to the extent that the disposition has been made with the consent of, or been subsequently ratified by, the court. A bankruptcy order made against a firm shall operate as if it were a bankruptcy order made against each of the persons who, at the time of the order, is a partner of the firm.

Singapore bankruptcy laws provide recourse against antecedent transactions carried out under circumstances in which there was an undervalue transaction or unfair preference. The Official Assignee may seek the court's assistance in unravelling transactions that should not have taken place for a period of time prior to the individual being adjudged bankrupt. These remedies are identical to those in insolvency proceedings (see “Corporate Insolvency” below).

Debt-Repayment Scheme

The Debt Repayment Scheme (“DRS”) is a voluntary scheme administered by the Official Assignee under the Bankruptcy Act. The purpose of the DRS is to help debtors who have debts of less than SGD 100,000 avoid bankruptcy by devising a debt repayment plan to pay their debts over a fixed period of time.

Upon receiving a bankruptcy application, the court may adjourn the application if the debtor's total liabilities are less than SGD 100,000, for an assessment of the debtor's eligibility and suitability for a DRS. The DRS will come into effect (on such date as may be specified by the Official Assignee) if the Official Assignee, after consultation with the creditors, approves a debt repayment plan proposed by the debtor. For the period of the DRS, no creditor is allowed to commence or proceed with any action against the debtor for any outstanding debt without the court's permission. The moratorium on proceedings is without prejudice to the right of any secured creditor to realise or otherwise deal with his security.

Corporate Insolvency

Liquidation

The law and procedure on insolvent winding-up in Singapore is comprehensively laid out in Part X of the Companies Act.

A Singapore company can be wound up either voluntarily or by the court. A voluntary winding-up may be either a member’s voluntary winding-up or a creditor’s voluntary winding-up. A key difference between voluntary winding-up and winding-up by the court is the method by which the winding-up is initiated. A members’ resolution is required in a voluntary winding-up but not in a winding-up by the court. An application to the court for winding-up can be brought by a creditor of the company, and the court may order the winding-up of a company on the ground of insolvency, if (amongst other things):

- The company is unable to pay its debts;
- An inspector appointed under the Companies Act has reported that he is of the opinion that the company cannot pay its debts and should be wound up; or
- The court is of the opinion that it is just and equitable that the company be wound up.

The making of a winding-up order brings into operation a statutory scheme for dealing with the assets of the insolvent company. A liquidator is appointed to administer the winding-up proceedings, to realise the assets in liquidation and to distribute the assets equitably.
amongst the company’s creditors. In line with the preservation of the company’s assets for the fair distribution amongst creditors, all dispositions of property of the company after the commencement of winding-up are void unless the court otherwise orders. In addition, a moratorium on proceedings is put in place to prevent legal action, enforcement or execution without the court’s leave.6

A company being wound up usually has insufficient assets to pay all its creditors in full, so the priority of recovery of the company’s creditors from the liquidation assets becomes crucial.

Creditors may be broadly divided into two classes: secured creditors and quasi-secured creditors who have proprietary rights against assets in the company’s possession, and unsecured creditors. The interests of secured creditors and quasi-secured creditors are recognised in winding-up proceedings, and these creditors are generally entitled to enforce their interests against the assets of the company, independently of the winding-up proceedings and ahead of unsecured creditors. Preferential debts (e.g. the costs and expenses of winding-up, wages and salaries of employees, and tax) are also paid out of the liquidation assets in priority of all other unsecured debts.

After the debts of the secured creditor(s) and the preferential debts of the winding-up are satisfied, the balance of the liquidation assets (if any) will be divided amongst the unsecured creditors of the company on a pari passu basis.

A liquidator also has certain powers available to recover the value of the company’s assets in certain circumstances, including (i) undervalue transactions and (ii) transactions with an unfair preference. These come in the form of seeking the court’s assistance in unravelling transactions that should not have taken place for a period of time prior to the commencement of winding-up.

**Undervalue Transactions**

On an application of the liquidator, the court may order a clawback or restore undervalue transactions that an insolvent company had entered into. The Bankruptcy Act defines three categories of undervalue transactions: a gift or a gratuitous transaction, a transaction entered into in exchange for marriage with the other party and a transaction in which the consideration received is significantly less than the value of the consideration provided by the insolvent company.

The period of time in which an undervalue transaction may be challenged is five years prior to the date of the winding-up application.

**Unfair Preferences**

In the same vein as undervalue transactions, the liquidator may apply to the court for an order to restore the position of the company to what it would have been had a party not been given an unfair preference by the company. An unfair preference occurs where a creditor, surety or guarantor is put in a better position than he would have been by an act of the company, and the act was influenced by a desire to put the creditor, surety or guarantor in a better position.

The relevant period of time here is six months prior to the commencement of the winding-up. However, if the unfair preference is given to an associate, the relevant period of time is two

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6 Sections 260, 262(3), 299(1) and 299(2) of the Companies Act (Chapter 50) apply to a winding-up by the court and a creditors’ voluntary winding-up. It is unclear whether the moratorium applies in respect of a members’ voluntary winding-up.
years. An associate is defined by statute and covers a wide category of people including spouses, family members, relatives, partners, directors, employees and trustees.

Corporate Rescue Mechanisms

Scheme of Arrangement

A scheme of arrangement provides a statutory regime to allow the company to vary or modify its obligations in relation to its debts and liabilities owed to its creditors or a class of creditors. The statutory scheme expressly provides for the restraint of proceedings, upon the application of the company, its members or creditors, against the company while a scheme is being proposed.

Section 210 of the Companies Act

Section 210 of the Companies Act provides a statutory mechanism for a scheme of arrangement that is binding on the company, its members and its creditors once sanctioned by the court. There are three stages by which a scheme of arrangement under section 210 becomes binding.

- First, an application must be submitted to court for an order that one or more meetings of members and/or creditors be summoned.
- Second, the scheme proposal(s) must be put before these meeting(s) and approved by a majority in number representing three-fourths in value of the claims of each class of creditors or members.
- If (and only if) the proposal(s) are so approved at the meeting(s), the court may then, at its discretion, sanction the scheme.

Clarity, Certainty and Finality

The overarching principles that the statutory regime for schemes of arrangement is premised upon are clarity, certainty and finality. The mechanism in section 210 of the Companies Act was designed to ensure that members and creditors are fully informed of, and have ample opportunity to raise objections on, the scheme before the court makes its final decision on whether to sanction the scheme. For example, every notice summoning a meeting must be accompanied by a statement explaining the effect of the compromise or arrangement and stating any material interest of the directors. After a scheme is sanctioned, the courts would necessarily be slow in hearing further objections or making any amendments to the scheme.

Flexibility of the Scheme

The Companies Act deliberately provides little guidance as to the requirement of the scheme document and no guidance on the terms to be proposed by the scheme. Accordingly, there is no limitation on how the scheme is to be structured, save that it is required to be approved by creditors and/or members, and sanctioned by the court. This allows flexibility in structuring a restructuring proposal that achieves the objectives of the scheme.

Singapore Courts’ Approach

In line with the above principles, the Singapore courts have consistently adopted a limited supervisory role in relation to the fairness and the reasonableness of the scheme and have been reluctant to substitute their own commercial judgment for that of the members and/or creditors. This cautious approach is in line with the view that at the core of the scheme was a commercial arrangement, the terms of which had been agreed to between the company and a majority of the creditors.
The Singapore courts have demonstrated a willingness to give effect to the terms of a scheme so long as the statutory requirements have been satisfied. In the case of *Daewoo Singapore Pte Ltd v CEL Tractors Pte Ltd*, CEL Tractors proposed a scheme of arrangement with its creditors, one of which was Daewoo. Daewoo held a guarantee given by one of the directors of CEL Tractors in respect of Daewoo's loan to the company. The scheme provided that CEL Tractors would make certain scheduled payments and grant share options to the creditors, in return for which the creditors would release both CEL Tractors and their respective guarantors from liability under the loan. Daewoo objected to the scheme at the sanction stage on the basis that a scheme of arrangement bound only the company and the creditors and therefore could not discharge or affect the liability of a third-party guarantor of the company's debts.

In its judgment, the Singapore Court of Appeal noted that the cases cited by Daewoo did not contain any express term requiring the creditors to extinguish or discharge the liability of a third party. It held that there was no reason in principle why a scheme of arrangement could not incorporate an express term to the effect that the creditors would release the guarantors from their obligations under a guarantee, and found the express term in the scheme releasing the liability of the third-party guarantor to be valid and effective.

In the case of *Re Reliance National Asia Re Pte Ltd*, an issue arose as to whether the court had the jurisdiction to grant an extension period for a creditor to file its proof of claim beyond the deadline stipulated in the court-sanctioned scheme. The court considered whether the scheme operated as a statutory contract or an order of court, and preferred the former approach. The court took the view that it had no jurisdiction to alter the substance of the scheme and impose upon creditors an arrangement to which they had not agreed, and consequently dismissed the application for an extension.

On appeal, the Court of Appeal considered that the approach of the court below was unduly restrictive and might lead to unjust consequences. The Court of Appeal opined that section 210(3) of the Companies Act stipulates that a scheme becomes binding only if it is approved by an order of the court, and therefore suggests that the efficacy of a scheme stems from the court order approving it. The Court of Appeal also pointed out that section 210(4) of the Companies Act, which states that the court "may grant its approval to a compromise or [an] arrangement subject to such alterations or conditions as it thinks just", reinforces the view that the Singapore courts were allowed a more participatory role in respect of schemes of arrangement.

The Court of Appeal felt that an extension was a matter of procedure and did not relate to the substance or materiality of the commercial decision of the scheme. It was also of the view that no prejudice would be caused to the respondent or the other scheme creditors if the extension was granted, and that severe prejudice would be caused to the appellant if no extension was granted. In the circumstances, the Court of Appeal allowed the appeal and granted the extension period.

The Singapore courts have also recently shown a willingness to grant an interim moratorium to the applicant company under section 210(10) of the Companies Act, which moratorium would provide the applicant company the much needed breathing space to engage in detailed negotiations with its creditors on the proposed terms of the scheme. This again demonstrates flexibility on the part of the Singapore courts to enable the objects of the restructuring to be achieved.

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7 [2001] 4 SLR 35.
8 [2007] SGHC 206.
9 *The Oriental Insurance Co Ltd v Reliance National Asia Re Pte Ltd* [2008] 3 SLR(R) 121.
Where a scheme of arrangement has been proposed for the purposes of or in connection with a scheme for the reconstruction of any company or the amalgamation of any two or more companies, where the undertaking or property of any company concerned in the scheme is to be transferred to another company, section 212 of the Companies Act gives the court the power to provide, either in the order approving the scheme or by a subsequent order, directions to facilitate the reconstruction or amalgamation.

A further advantage that the flexibility of a scheme has is that it permits bigger creditors to be repaid proportionately less than smaller creditors. Dictating that the assets be distributed in a pari passu manner akin to liquidation would not only decrease the flexibility available to the planner of schemes but may also dampen what the scheme of arrangement could achieve and sound the death knell of the company prematurely.

Implementing the Scheme

The case of *The Royal Bank of Scotland NV v TT International Ltd*¹⁰ provides useful guidance on how schemes of arrangement should be implemented in the Singapore context. In that case, the Court of Appeal laid down the following principles:

- A proposed scheme manager must act transparently and objectively and should not be in a position of conflict of interest. He must strike the right balance and manage the competing interests of successfully securing the approval of his proposed scheme and uncompromisingly respecting the procedural rights of all involved in the scheme process.

- A scheme creditor is entitled to examine the proofs of claim submitted by other scheme creditors in respect of a proposed scheme if he produces prima facie evidence of impropriety in the admission or rejection of such proofs of claim.

- A scheme creditor should be notified of the proposed scheme manager’s decisions to admit or reject his own and other creditors’ proofs of claim before the votes are cast at the creditors’ meeting.

- A scheme creditor may appeal the proposed scheme manager’s decisions to admit or reject his own and other creditors’ proofs of claim for the purposes of voting. However, such appeals to court should be taken only after the votes have been counted and it can be seen whether the vote in question would affect the result, preferably concurrently during the sanction stage.

- Scheme creditors should be classified differently for voting purposes when their rights are so dissimilar that they cannot sensibly consult together with a view to their common interest. In other words, if a creditor’s position will improve or decline to such a different extent vis-à-vis other creditors simply because of the terms of the scheme assessed against the most likely scenario in the absence of scheme approval, then it should be classified differently. However, the courts will take a broad, practical and objective approach in analysing creditor relationships and ensure that the application of this principle does not lead to an impractical mushrooming of classes that could potentially result in the creation of unjustified minority vetoes.

- Related party creditors and contingent creditors should generally have their votes discounted. Wholly owned subsidiaries should have their votes discounted to zero and should effectively be classified separately from the general class of unsecured creditors.

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¹⁰ [2012] 2 SLR 213.
As a final point, the Singapore Court of Appeal has also held that a scheme manager should ensure, prior to the sanction of the scheme, that the financially distressed company promptly discloses to the scheme creditors and the court all benefits accruing to the proposed scheme manager.11

Judicial Management

Judicial management is another form of corporate rescue that a company in financial difficulty can rely on to stave off action by its creditors and buy time to work out a way to rescue the business, to make an arrangement with its creditors or to carry out a controlled realisation of its remaining assets to obtain the best value under the circumstances.

Application

The judicial management procedure is contained in Part VIIIA of the Companies Act. Before an application for judicial management can be filed, the company or its creditor(s) must be of the opinion that the company is or will be unable to pay its debts, and that there is a reasonable probability of rehabilitating the company or of preserving all or part of its business as a going concern or that otherwise the interests of creditors would be better served than by resorting to a winding-up.

The court will grant the judicial management order only if it is satisfied that the company is or will be unable to pay its debts, and that the judicial management would be likely to achieve one or more of the following purposes:

- The survival of the company as a going concern;
- The approval of a scheme of arrangement under section 210; or
- A more advantageous realisation of the company’s assets than in a winding-up.

To facilitate the rehabilitation of the company, once an application for a judicial management order is made, and until the order is made or the application is dismissed, there is a moratorium on the winding-up of the company, on enforcement against the company and on the start or continuation of any legal process against the company or its property.

Powers of the Judicial Manager

The judicial manager has the power to set aside certain transactions entered into by the company prior to the judicial management on the grounds of being a transaction at an undervalue, being an unfair preference or being an extortionate credit transaction. These powers granted to the judicial manager allow him to avoid transactions that have the result of depleting the company’s property to the prejudice of the company and its creditors.

The grant of such powers to judicial managers is unique to Singapore; similar powers are not accorded to judicial managers in other jurisdictions. These powers are similar to the powers of a liquidator as described in the section above.

The judicial manager can also rely on wide-ranging provisions, such as section 227X(b) of the Companies Act,12 in his efforts to resuscitate the company, to seek an extension of the

12 Section 227X(b) of the Companies Act (Chapter 50) states: “At any time when a judicial management order is in force in relation to a company under judicial management – (b) sections 337, 340, 341 and 342 shall apply as if the company under judicial management were a company being wound up and the judicial manager were the liquidator, but this shall be without prejudice to the power of the Court to order that any other section in Part X shall apply to a company under judicial management as if it applied in a winding-up by the Court and any reference to the liquidator shall be taken as a reference to the judicial manager and any reference to a contributory as a reference to a member of the company”.
judicial management order from the court for the purpose of the better realisation of the assets of the company. In the case of *Neo Corp Pte Ltd (in liquidation) v Neocorp Innovations Pte Ltd*, the Singapore Court of Appeal showed its willingness to support the judicial management regime. One of the issues in that case was whether legal proceedings commenced by a judicial manager challenging a company transaction on grounds of unfair preference or undervalue under section 227T of the Companies Act could be continued by a liquidator. While the court held in the negative, it also intimated that the judicial manager was not without recourse in his bid to realise the best value of the assets and should have relied on section 227X(b) to extend the judicial management order.

Conclusion

Singapore’s statutory regime provides adequate measures for a company in financial difficulty to avoid the end-game of liquidation, to ward off creditors and to ultimately survive the insolvent period. The Singapore courts’ approach has been supportive of these corporate rescue regimes and has allowed companies and their creditors wide discretion in this regard. This is counter-balanced by a requirement for fairness and transparency in the manner in which the rescue regimes are carried out. The provisions for these regimes (and for liquidation) also permit a clawback of company property disposed against the interests of the company or its creditors.

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13 [2006] 2 SLR 717.
South Africa

Overview and Introduction

South African insolvency law regulates three main types of insolvency proceedings, namely the sequestration of personal estates, the winding-up of companies and the winding-up of close corporations. Furthermore, the law regulates proceedings which are aimed at rescuing businesses in dire financial straits. This Guide provides a general overview of the insolvency regime in South Africa, specifically in relation to companies; a brief overview of the position of cross-border insolvency in South Africa; as well as an examination of the new corporate restructuring provisions relating to business rescue proceedings.

Applicable Legislation

The insolvency regime in South Africa is governed by three statutes, the application of which depends on the type of insolvency proceedings in issue. The sequestration of a natural person’s estate is governed by the Insolvency Act 24 of 1936 (the “Insolvency Act”), whilst the winding-up of close corporations is regulated by the Close Corporations Act 69 of 1984 (the “Close Corporation Act”). The law regulating the winding-up of companies (both public and private) is contained chiefly in the Companies Act 61 of 1973 (the “Old Companies Act”) (which, pursuant to the provisions of item 9 of Schedule 5 of the Companies Act 71 of 2008 (the “New Companies Act”), remains in force under the new company law regime) as read with the laws relating to insolvency insofar as they are applicable. Only companies that are “insolvent” may be wound up in terms of the provisions of the Old Companies Act, whereas “solvent” companies must be wound up in terms of the New Companies Act.

As part of the transition to the new company law regime, the New Companies Act stipulates that no new close corporations may be incorporated from the date of promulgation. Furthermore, all existing close corporations were afforded an opportunity to convert to a private company with minimal administrative and financial expense. The legislation is therefore a clear indication of South Africa’s desire to move away from the use of close corporations as juristic trading entities. It is for this reason that a discussion of the insolvency laws relating to close corporations has been omitted from this Guide; however, it should be noted that the provisions in the Close Corporation Act relating to the winding-up of close corporations effectively incorporate many of the provisions of the Old Companies Act and simply make these provisions applicable to close corporations.

In relation to the international aspects of restructuring and insolvency law in South Africa, the common law of cross-border insolvency is currently applicable with respect to the recognition in South Africa of representatives appointed in formal insolvency proceedings instituted overseas. The Cross-Border Insolvency Act 42 of 2000 (the “Cross-Border Insolvency Act”), once in operation, will govern much of the law relating to such recognition.

The Test for Insolvency; Grounds for a Winding-up

A person or entity is generally considered to be insolvent when he or it is unable to pay his/its debts; however, the legal test of insolvency under South African law is whether a debtor’s liabilities, fairly estimated, exceed the debtor’s assets, fairly valued. An inability to pay debts is therefore, at most, merely evidence of insolvency.

Apart from the test of insolvency, section 344 of the Old Companies Act sets out the eight grounds on which a court may wind up a company, the details of which appear below.
Special Resolution

The court may wind up a company if it has passed a special resolution (i.e. by 75% of the general meeting of members) to be wound up by the court.

Premature Commencement of Business

The court may wind up a company if it has commenced business before the Registrar has issued a certificate.

Failure to Commence or Continue with Business

The court may wind up a company if it has not commenced its business within a year of its incorporation, or if the company has suspended its business for a whole year.

Public Company’s Members Fewer than Seven

A public company is required to have at least seven members and may be wound up by a court if the number drops below seven.

Loss of Capital

The court may wind up a company if 75% of its issued share capital has been lost or becomes useless for its business.

Inability to Pay Debts

The court may wind up a company if it is unable to pay its debts. A company will be deemed to be unable to pay its debts in each of the following circumstances:

- A creditor to whom the company is indebted in a sum not less than ZAR 100 has served a demand on the company demanding payment and the company has neglected to pay the sum for three weeks thereafter;

- A warrant of execution (or other process) issued on a judgment against the company has been returned by the sheriff with an endorsement that he did not find disposable property sufficient to satisfy the judgment, or that the disposable property found and sold did not satisfy the process; or

- It is proved to the satisfaction of the court that the company is unable to pay its debts.

Dissolution of External Company

The court may wind up an external company if it has been dissolved in the country in which it was incorporated, has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs.

Just and Equitable

In addition to the seven specific grounds for winding-up listed above, the court may wind up a company if it appears that it is just and equitable that the company should be wound up. The courts do not consider this ground to be a limitless “catch-all” clause and have resorted to winding up companies under this ground only in limited instances, for example, where the main object for which the company was formed is not possible of being attained; where the company’s objects are illegal or the company was formed to defraud the persons invited to subscribe for its shares; where the minority shareholders are oppressed by the controlling shareholders; and where there is a justifiable lack of confidence in the conduct and management of the company’s affairs.
Classes of Creditors – A Brief Summary

The broad categories of priorities attaching to creditor claims in insolvency cases in South Africa are comparable to the classes of creditors in England and Wales. In general terms, there are three types of creditors whose claims rank differently depending on a number of factors.

A secured creditor is in the strongest position in a liquidation, as a secured claim is one in respect of which the creditor holds security, i.e. has a preferent right over property of the insolvent estate by virtue of a landlord’s legal hypothec, a pledge, a right of retention or a special mortgage. In this context, a preferent right to payment means a right to payment “out of” the property in preference to other claims. Accordingly, the creditor has a right to be paid first out of the proceeds of the realisation of the secured property.

If, in terms of the Insolvency Act, a right to payment “out of” the property of the estate is enforceable before other creditors’ rights, but is not secured, the preferent creditor’s claim ranks for payment out of the free residue before the claims of the concurrent creditors. For example, the bondholder under a general notarial bond holds a preferent claim but is not a secured creditor.

Finally, a concurrent claim is one which is neither secured nor preferent in terms of the Insolvency Act, and it ranks behind both secured and preferent claims.

Business Rescue Proceedings

Prior to the enactment of the New Companies Act, the primary corporate rescue mechanism in South Africa was that of judicial management, as contained in the Old Companies Act. This, however, was a largely unsuccessful mechanism and has been effectively replaced by a new corporate rescue procedure, business rescue, as contained in Chapter 6 of the New Companies Act, which came into operation on 1 May 2011.

Although corporate rescue is categorised as an insolvency procedure, a policy decision was made to include it in the New Companies Act instead of in a unified insolvency statute. Accordingly, the provisions relating to business rescue are not applicable to other forms of business enterprise such as partnerships, business trusts and sole proprietorships.

The provisions in Chapter 6 of the New Companies Act are aimed at preventing the demise of viable companies by making provision for their possible rescue. If a plan cannot be devised to rescue the company, then a plan that would ensure a better return for the company’s creditors than the return which would ensue pursuant to its winding-up is the next objective. If this is not possible, then the company ought to be wound up. In practice, it is observed that business rescue is not always a viable option to prevent the liquidation of a company, as the success of the business rescue proceedings relies substantially on whether there is sufficient financing available and whether the problem that caused the financial straits can be extricated from the business. In some cases, even the nature of the business itself is a significant factor in the prospects of success.

Initiation of Business Rescue Proceedings

There are two ways in which business rescue proceedings may be commenced. The first way is by resolution of the board of directors, and the second is upon application to the court by an affected person.

Section 129(1) of the New Companies Act provides that the board of directors of a company may take a formal decision by majority vote to commence business rescue proceedings, provided the board has reasonable grounds to believe that the company is financially
distressed and there appears to be a reasonable prospect of rescuing the company. This
general power of the board of directors is, however, qualified by section 129(2)(a) of the New
Companies Act, which provides that the board of directors may not adopt a resolution to
commence business rescue proceedings if steps to liquidate the company have already
been “initiated”, i.e. if an application for the liquidation of the company has been put before
the court.

The second manner in which business rescue proceedings may be commenced is in terms
of section 131(1) of the New Companies Act, where an affected person applies to court for
an order placing the company under supervision and commencing business rescue
proceedings. An “affected person” in the context of business rescue proceedings includes
shareholders, creditors, registered trade unions representing the company’s employees and
the individual employees themselves. In such a circumstance, the affected person would
have to satisfy the court either that the company is financially distressed or has failed to pay
any amount due in respect of its employees, or that it is otherwise just and equitable to
commence the proceedings for financial reasons and there is a reasonable prospect of
rescuing the company. The Supreme Court of Appeal recently confirmed that such an
application can be brought even after an order for the winding-up of a company has been
granted.

In this regard, a company would be “financially distressed” if it appears to be commercially
insolvent (i.e. reasonably unlikely to be able to pay all its debts as and when they fall due
within the succeeding six months) or is reasonably likely to become insolvent (i.e. its
liabilities are reasonably likely to exceed its assets within the succeeding six months).

In the case of voluntary commencement, within five days after the commencement of the
business rescue proceedings, the company must publish in the prescribed manner a notice
of the resolution and its effective date, as well as a sworn statement of the facts relevant to
the grounds on which the board’s resolution was founded. Notice must be given in the
prescribed manner, i.e. by delivering a copy to each and every affected person, displaying a
copy at the registered office of the company, publishing a copy on any website maintained
by the company, and if it is a listed company, on any electronic system maintained by the
exchange for the communication of information by and among companies listed on the
exchange.

Furthermore, within the same time (i.e. five days of commencement), the company must
appoint a suitably qualified business rescue practitioner, who must consent to the
appointment in writing, and file a notice of appointment with the Companies and Intellectual
Property Commission. The notice must also be published to all affected persons in the
prescribed manner or by informing each affected person of the availability of a copy of the
notice.

Due to the fact that the initiation of a voluntary business rescue proceeding by a company is
open to potential abuse, an affected person may approach the court in appropriate
circumstances to request an order setting aside the business rescue resolution adopted by
the board, setting aside the appointment of the business rescue practitioner, or requiring the
appointed business rescue practitioner to provide security (section 130 of the New
Companies Act).

In the case of compulsory initiation of business rescue proceedings by an affected person
under section 131 of the New Companies Act, the business rescue proceedings commence
at the time the application is made to court.
Moratorium and Property Interests

For the duration of the business rescue proceedings, there is a general moratorium on legal proceedings, including any enforcement action, against a company or in relation to any property belonging to the company or lawfully in its possession. Although there is no definition of the terms “legal proceedings” or “enforcement action”, the intention of the legislature was to cast the net as wide as possible to include every conceivable type of action against the company (section 133 of the New Companies Act). The aforesaid intention was highlighted in a recent Supreme Court of Appeal decision where the court held that the phrase “legal proceeding” includes arbitration proceedings.

Furthermore, section 134 of the New Companies Act provides that the disposal of company property during the business rescue proceedings may only be done in circumstances where it is required for the normal operation of the business, or as part of a business rescue plan. Disposals of company property may also occur in a *bona fide* arm’s length transaction for fair value, approved in advance and in writing by the business rescue practitioner.

Effect on Employees and Contracts

The protection of employees during the business rescue process is of high regard, and the employees continue to be employed throughout the proceedings on the same terms and conditions that applied prior to the commencement of the business rescue proceedings. Any planned retrenchment is still subject to sections 189 and 189A of the Labour Relations Act 66 of 1995, as well as any other employment-related legislation.

On the other hand, contracts other than employment contracts may be suspended (entirely, partially or conditionally) by the business rescue practitioner for the duration of the business rescue proceedings. The business rescue practitioner may also apply urgently to a court to cancel (entirely, partially or conditionally), on any terms that are just and reasonable in the circumstances, any obligation of the company in terms of that contract. In such circumstances, the only remedy of an aggrieved contracting party is to claim damages from the company.

Participation of Creditors, Employees, Shareholders and the Directors of the Company – Generally

In addition to enjoying rights as an affected person (e.g. the right to be notified), each creditor is entitled to formally participate in legal proceedings relating to the business rescue proceedings, to form a creditors’ committee, to be consulted by the business rescue practitioner during the development of a business rescue plan, and to vote on the business rescue plan. Creditors are also entitled to participate in the development of a business rescue plan on a more informal level by making proposals for a business rescue plan to the practitioner.

Employees have similar rights to participate in legal proceedings relating to the business rescue proceedings, to form a committee of employees’ representatives and to be consulted by the business rescue practitioner during the development of a business rescue plan.

Shareholders are affected persons in terms of the New Companies Act and therefore have the rights bestowed upon affected persons. Furthermore, shareholders have a right to participate in legal proceedings but may vote on the business rescue plan only if the adoption and implementation of the plan would alter the rights associated with the class of securities held by that shareholder.

During a company’s business rescue proceedings, each director of that company must continue to exercise the functions of a director, subject to the authority of the business
rescue practitioner, and remains bound by the duties and obligations which existed prior to the commencement of the business rescue proceedings. In addition, the directors are obliged to cooperate with the business rescue practitioner and provide the business rescue practitioner with all books, records and information relating to the affairs of the company. If a director fails to comply with his duties and obligations, the business rescue practitioner may apply to court for an order removing the director from office.

Meetings and the Business Rescue Plan

Separate first meetings are held, on notice, for the creditors and the employees’ representatives of the company, although in practice, these meetings are held on the same day and at the same venue, but at different times. Employees who are also creditors of the company are entitled to attend both meetings.

At the first meeting of creditors, the business rescue practitioner is obliged to inform the creditors whether or not he believes there is a reasonable prospect of rescuing the company. The business rescue practitioner may also receive proofs of claim by creditors.

At the first meeting of employees’ representatives, the business rescue practitioner must similarly inform the creditors whether or not he believes there is a reasonable prospect of rescuing the company.

After consulting the creditors, employees, shareholders and management of the company, the business rescue practitioner must prepare and publish a business rescue plan for consideration and possible adoption.

Once a plan is published, a meeting to determine the future of the company is held, on notice. At this meeting, the creditors, and the holders of any issued security of the company if their rights are affected, decide whether or not to adopt the business rescue plan proposed by the business rescue practitioner. As the entire process of discussing, voting on or amending the plan has the potential to be long and convoluted, this meeting may be adjourned from time to time.

If the business rescue plan is approved at the meeting to determine the future of the company by a majority of the holders of more than 75% of the creditors’ voting interests present at the meeting and the votes in support of the proposed plan include at least 50% of the independent creditors’ voting interests present at the meeting, then the plan is binding on all the creditors, regardless of whether or not they were present at the meeting or how they voted.

If the business rescue plan is rejected, the business rescue practitioner may either seek a vote of approval from the holders of the voting interests to prepare and publish a revised plan, or advise the meeting that the company will apply to court to set aside the result of the vote on the grounds that it is inappropriate.

Termination of Business Rescue Proceedings

The business rescue procedure provided for is designed to last for a very brief period of only three months. Business rescue proceedings can then be terminated in the following ways:

- When the court sets aside the resolution or order commencing the proceedings;
- When the court converts the business rescue proceedings into liquidation proceedings;
Winding-up

As stated earlier, the law regulating the winding-up of companies (both public and private) is contained mainly in the Old Companies Act which, pursuant to the provisions of item 9 of Schedule 5 of the New Companies Act, remains in force under the new company law regime, as read with the laws relating to insolvency insofar as they find application. It must be remembered, however, that only companies that are “insolvent” may be wound up in terms of the provisions of the Old Companies Act, whereas “solvent” companies must be wound up in terms of the New Companies Act.

A company may be wound up in two ways: by the court or voluntarily.

Procedure – Voluntary Winding-up

A company (other than an external company) may be wound up voluntarily if it has adopted a special resolution and that resolution has been registered by the Registrar. The special resolution will state whether the winding-up is a members’ voluntary winding-up or a creditors’ voluntary winding-up.

A members’ voluntary winding-up may only be initiated if the company is able to pay its debts in full and is resorted to in circumstances where, for example, the purpose for which the company was formed has been fulfilled or the members responsible for running the company are no longer on amicable terms. As the company is “solvent”, the provisions of the New Companies Act apply.

Conversely, a creditors’ voluntary winding-up may be resorted to in circumstances where a company is unable to pay its debts. The procedure resembles that of a compulsory winding-up in that meetings of creditors are held and the liquidator is subject to the directions of the creditors who have proved claims. The directors must prepare a statement of the company’s affairs and lay it before the meeting convened to pass the resolution.

Procedure – Compulsory Winding-up

Winding-up by the court (sometimes called compulsory winding-up) is initiated by an application to the High Court, accompanied by an affidavit, usually brought by a creditor. The company itself, one or more of its members and the Master of the High Court all also have the requisite locus standi to bring such an application, however.

Prior to bringing the application, the applicant must give sufficient security for the payment of all fees and charges necessary for the prosecution of all winding-up proceedings and of all costs of administering the company in liquidation until a provisional liquidator has been appointed or, if none is appointed, of all fees and charges necessary for the discharge of the company from the winding-up.

The applicant is also required to serve a copy of the application on the Master, who may report to the court any facts which may justify postponing or dismissing the application. Furthermore, the applicant must furnish a copy of the application to every registered trade
union that represents any of the company’s employees, the employees themselves, the South African Revenue Service and the company itself (unless the application is made by the company or the court dispenses with the requirement in the interests of the company or creditors thereof).

The court may grant or dismiss any application for winding-up; adjourn the hearing, conditionally or unconditionally; or make any interim order or any other order it may deem just. In practice, the court usually makes a provisional winding-up order (provided the applicant has made out a prima facie case), and issues a rule nisi calling on all interested parties to show cause on the return date why the court should not make the order final.

Consequences of Winding-up

Winding-up establishes a creditors’ concursus which is aimed at ensuring that the company’s property is collected and distributed among creditors in the prescribed order of preference. The company does not lose its corporate identity or title to its assets, but from the commencement of the winding-up, the powers of the directors cease and the directors are discharged (in a voluntary winding-up, however, the liquidator, creditors or members may sanction a continuance of directors’ powers), the company’s property is deemed to be in the custody and under the control of the Master until a provisional liquidator has been appointed and assumes office, and the company may not continue with its business, except insofar as it may be necessary for its beneficial winding-up.

In amplification of the above, after the winding-up of a company has commenced, any transfer of shares of the company without the liquidator’s permission is void, and if the company is unable to pay its debts, every disposition of its property (including rights of action) not sanctioned by the court is similarly void. Furthermore, no set-off can take place unless mutuality of the respective claims existed at the time of the winding-up.

Furthermore, all civil proceedings, including judgments, by or against the company are suspended from the time the winding-up order is made or a special resolution for the voluntary winding-up is registered until the appointment of a liquidator or liquidators, as the case may be, by the Master.

Meetings and Proofs of Claim

Following the granting of a winding-up order, be it voluntary or a compulsory winding-up, at least two creditors’ meetings must be held. The purposes of the meetings are to allow creditors to consider the company’s statement of affairs, prove claims and, in the case of the first meeting, nominate a liquidator as well as provide him with suitable directions and authority on dealing with assets, claims against the estate and related matters. The directors and officers of the company are obliged to attend these meetings.

In regard to the proof of claims, section 366(2) of the Old Companies Act provides that the Master of the High Court may fix a time or times within which creditors of the company are to prove their claims or otherwise be excluded from the benefit of any distribution under any account lodged with the Master before those claims are proved. Usually, claims will be proven at either the first or second meeting of creditors, on a date as provided for by the liquidator.

A members’ meeting must be held in a winding-up by the court and in a creditors’ voluntary winding-up. The purpose of this meeting is to allow the members to consider the company’s statement of affairs and nominate a liquidator; however, if these issues were dealt with at the time the resolution commencing winding-up was taken, this meeting may be dispensed with.
Liquidation and Distribution Account and Distribution of Assets

The liquidator’s primary duty is to take possession of all the movable and immovable property of the company, realise this property in the prescribed manner, apply the proceeds towards payment of the costs of the winding-up and the claims of creditors, and distribute the balance among the members. The liquidator stands in a fiduciary relationship to the company, to the body of its members as a whole, and to the body of its creditors as a whole.

Within six months of his appointment, a liquidator must prepare and lodge with the Master a liquidation and distribution account or, if necessary, a liquidation and contribution account that details all assets of and claims against the company. Once the account has been confirmed, the liquidator must distribute the estate or collect contributions in accordance with the account. Any assets remaining after payment of costs and creditors must be distributed among the members according to their rights and interests in the company.

Clawback and Recovery

In addition to being vested with the property of the company, the liquidator has the means of recovering certain property alienated by the company before its winding-up. The liquidator may ask the court to set aside certain dispositions made by the company before the winding-up.

As set out above, the laws of personal insolvency apply in the winding-up of a company unable to pay its debts, through express incorporation in the Old Companies Act, in respect of any matter not specifically provided for in the Old Companies Act. In particular, the Old Companies Act provides that a disposition made by a company of its property which, if made by an individual could be set aside in the event of his insolvency, may be set aside in the event of the company being wound up and unable to pay all its debts. The circumstances in which dispositions may be set aside are therefore contained in the Insolvency Act or common law, as the case may be, and are each discussed in turn below.

Dispositions Made Not for Value

In terms of section 26(1) of the Insolvency Act, as read with the Old Companies Act, a disposition made not for value can be set aside by the liquidator if he can prove that:

- The company made the disposition;
- The disposition was made no more than two years prior to liquidation (unless the liquidator can also prove that immediately after the disposition was made, the liabilities of the company exceeded its assets);
- At the time when, or immediately after, the disposition was made, the company’s liabilities exceeded its assets; and
- No value was received for the disposition.

It is not necessary to establish whether or not the company intended to prejudice creditors by making the disposition, as the object of this provision is simply to prevent a company on the brink of liquidation from impoverishing its estate by giving away assets without receiving any appreciable advantage in return.
Disposition Which Prefers One Creditor above Another: Voidable Preference

Section 29(1) of the Insolvency Act, as read with the Old Companies Act, provides that a court may set aside a disposition made by the company not more than six months before the liquidation proceedings commenced, if;

- The disposition had the effect of preferring one of the company’s creditors above another; and
- Immediately after the disposition was made, the liabilities of the company exceeded the value of its assets.

The rationale behind this provision is that a company ought not to favour certain of its creditors prior to liquidation to the general prejudice of the creditors’ concursus.

The disposition does not have to be made directly to the creditor. It is required that payment must merely have had the effect of preferring the creditor, as would, for example a payment made to a creditor of a creditor.

The test for whether or not a creditor has been preferred is whether the proper distribution of assets as envisaged by the Act has been compromised and a creditor has benefited more or been paid earlier than would have been the case if he had been paid a dividend in due course.

It should be noted that there is a proviso in section 29(1) that the court cannot set aside a disposition if the person in whose favour it was made proves that it was made in the ordinary course of business and that it was not intended to prefer one creditor above another. A thorough exposition of the proviso in section 29(1) is not relevant for present purposes save to say that a disposition in the ordinary course of business requires an objective enquiry regarding whether the disposition was one which would normally be entered into between solvent business persons. Furthermore, a company will not be held to have intended to prefer if it is established that, when the disposition made, liquidation was not contemplated or expected.

Disposition Intended to Prefer One Creditor: Undue Preference

Section 30 of the Insolvency Act, as read with the Old Companies Act provides that a court may set aside a disposition that was made:

- By the company at any time before the liquidation;
- With the intention of preferring one creditor above the others; and
- When the company’s liabilities exceeded its assets.

This is a powerful provision, and there is no defence available to the person benefitted by the disposition.

The test for determining whether the company had the intention to prefer is whether the primary intention in making the disposition was to disturb the proper distribution of the company’s assets on insolvency.

Personal Liability of Directors and Officers

Chapter XIV of the Old Companies Act, and in particular section 425 thereof as read with the Insolvency Act, provides for a number of criminal sanctions to be placed on non-compliant
Directors and officers. In light of the repeal of certain provisions of the Old Companies Act, the personal liability of directors is governed by the Old Companies Act, the New Companies Act and Insolvency Act.

Failure to Make or Lodge Statement of Affairs

Section 363(8) of the Old Companies Act provides that a failure to make or lodge a statement of affairs is an offence, carrying the sanction of a fine, imprisonment for a period not exceeding 12 months, or both.

Making a False Statement in Statement of Affairs

Section 214(1)(a) of the New Companies Act makes it an offence for a person, with a fraudulent purpose, to knowingly provide false or misleading information in any circumstances in which the New Companies Act requires the person to provide information or give notice to another person. The penalty for such an offence is a fine, imprisonment for a period not exceeding 10 years, or both.

Giving False Evidence under Interrogation

A person who wilfully makes a false statement while being interrogated on oath at a meeting of creditors commits an offence, carrying the penalty provided by law for the crime of perjury, if such statement is relative to the subject on which the person is interrogated and he knows of the falsity of the statement or does not know or believe it to be true (section 139(2) of the Insolvency Act).

Concealment or Destruction of Books or Other Documents

Section 132(a) of the Insolvency Act, read with section 339 of the Old Companies Act, makes it an offence for a person to conceal or destroy the books or assets of the company or allow another person to do so. The sanction for such conduct is three years’ imprisonment if it is found that the person had no intention to defraud. Furthermore, if a person is a party to the falsification of any accounting records of a company, irrespective of the intention of such person, the penalty is a fine, imprisonment for a period of 10 years, or both.

Failure to Notify Change of Address

A director or secretary of a company who changes his residential or postal address after the commencement of the winding-up of the company, but before the liquidator’s final account, and does not notify the liquidator of the new address within 14 days, is liable for a fine, imprisonment for a period not exceeding six months, or both.

Offences in Relation to Examinations in Terms of Section 417 of the Old Companies Act

If a person is summoned, by a commissioner who is not a magistrate, to attend a commission of enquiry, failure to do so without sufficient cause is an offence. Where a person is summoned by the Master, in addition to the above which is an offence, each of the following acts also constitutes an offence: failure to remain in attendance without sufficient cause; refusal to be sworn or to affirm as a witness; failure to answer, without sufficient cause, fully and satisfactorily any question lawfully put to him; and failure, without sufficient cause, to produce books or papers in his custody or under his control which he was required to produce. The penalty for these offences is a fine, imprisonment for a period not exceeding 12 months, or both.
Participation in Reckless or Fraudulent Conduct of Company’s Business

Section 424(1) of the Old Companies Act provides that any person who was, prior to liquidation, knowingly a party to the carrying on of business of the company recklessly, or with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct. In order to establish liability in terms of section 424, the relevant person must be guilty of intentional deceit or of reckless conduct. Reckless conduct may consist of blameworthy conduct characterised by a failure to take due care in managing the company which is detrimental to the company and others and exhibits a high degree of disregard for the standards observed by honest and diligent men of affairs. It may also be demonstrated by a similarly uncaring and careless failure to attend to the company’s business, or to prevent foreseeable harm from being caused, by failing to take reasonable preventative measures against such eventualities. An offence carries the sanction of a fine, imprisonment for a period not exceeding 12 months, or both.

Section 22(1) of the New Companies Acts introduced a wider prohibition than that of section 424 of the Old Companies Act insofar as it prohibits a company from carrying on business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purposes. Section 22(2) of the New Companies Act then introduces a novel concept aimed at deterring the trading by a company in contravention of section 22(1) or in a situation where it is commercially insolvent, i.e. where it is experiencing cash flow difficulties to the extent that it is unable to pay its debts as and when they fall due. The subsection mandates the Companies Commission to issue a notice to the company to provide reasons why it should be permitted to carry on business or trade.

Cross-Border Insolvency

Cross-border insolvency deals with a sequestration or a winding-up insolvency which affects property or debts in a jurisdiction other than the one in which the relevant court order is granted. Therefore, in a cross-border insolvency, the law of insolvent and winding-up intersects with the conflict of laws (private international law). A full exposition of the law relating to cross-border insolvency is beyond the ambit of this Guide. Accordingly, what follows is a brief description of the main problems associated with cross-border insolvency, followed by a brief description of the South African common law of cross-border insolvency and the Cross-Border Insolvency Act.

The main problems presented by cross-border insolvency include the globalisation of international business, limitations on state power, lack of international instruments for dealing with cross-border insolvency law and the conflict between the universalist and territorialist approaches to cross-border insolvency law. Solutions to deal with these problems, amongst others, are outlined in the United Nations Commission on International Trade Law’s “Model Law on Cross-Border Insolvency” (1997); however, this Model Law is not a treaty but simply a template which individual states are free to adopt and adapt. South African cross-border insolvency law is presently still governed by common law principles. The legislature has passed a South African version of the Model Law called the Cross-Border Insolvency Act; however, the Act will only come into effect once the Minister of Justice has designated the foreign countries to which it will apply.

South African Common Law of Cross-Border Insolvency

The common law provides that movable property is governed by the law of the natural person’s domicile (lex domicilii). On the other hand, immovable property is governed by the law of the place where the immovable property is situated (lex situs), regardless of whether
the person is an individual or juristic person. In terms of South African law, however, a liquidator of an external company (foreign representative) who seeks to deal with company assets located in South Africa is required to apply for recognition to the High Court of South Africa before dealing with those assets, regardless of whether the assets are movable, immovable or incorporeal.

The South African courts apply the principles of comity, convenience and equity in exercising their discretion to recognise the liquidator (foreign representative), as recognition allows him to rely on domestic South African law in carrying out his duties.

An external company registered as such in South Africa may be wound up as though independent of its related foreign company and vice versa. It is therefore possible that the company may be subject to simultaneous, concurrent winding-up processes; however, the discontinuation of foreign winding-up proceedings does not in itself affect the South African process as the respective liquidators deal independently with the assets and liabilities of the company in the various countries.

Cross-Border Insolvency Act

The Cross-Border Insolvency Act includes chapters on fundamental principles, access of foreign representatives and creditors to South African courts, recognition of foreign proceedings and relief, cooperation with foreign courts and foreign representatives, and concurrent proceedings. The purpose of the Cross-Border Insolvency Act is to facilitate cooperation between South African courts and foreign courts in cross-border insolvency matters. This in turn improves legal certainty for trade and investment, promotes good administration to protect creditors and other interested persons, including the debtor, protects assets and maximises their value, protects investment and saves jobs.

The Cross-Border Insolvency Act applies where a foreign court or representative asks a South African court for assistance in foreign proceedings and, conversely, where such help is requested in a foreign court in proceedings under South African law. It also applies where foreign proceedings and South African proceedings run concurrently as regards the same debtor, or where creditors or other interested foreigners ask to begin or take part in South African insolvency proceedings. The Cross-Border Insolvency Act, however, is limited in its operation to certain designated states.

When it comes into force in the international system for cooperation intended by the Model Law, the Cross-Border Insolvency Act will provide a mechanism for foreign representatives to gain access to South African proceedings and vice versa. Despite the limitation by designation requirements, the Cross-Border Insolvency Act will enable South African courts and practitioners to play a positive role in cooperating with their foreign counterparts. Once the foreign representatives have gained access to the South African legal system through the utilisation of the Cross-Border Insolvency Act, they will then have to abide by the relevant South African rules, both substantively and procedurally.

Compromise Procedure (Alternative to Liquidation)

Prior to the repeal of the Old Companies Act, section 311 of the Old Companies Act, read with section 312, provided for a compromise or arrangement between a company and its creditors, or any class of creditors, even in instances where the company was being wound up.

In terms of section 155 of the New Companies Act, irrespective of whether or not the company is financially distressed as defined in section 128(1)(f), unless the company is engaged in business rescue proceedings, the board of directors of the company or, if the
company is being wound up, its liquidator may propose an arrangement or a compromise of its financial obligations to all of its creditors, or to all of the members of any class of its creditors. The proposal and a notice of a meeting to consider the proposal must be delivered to all of the creditors of the company or every member of the relevant class of creditors whose name or address is known to or can be reasonably obtained by the company, and to the Companies Intellectual Property Commission.

A proposal in terms of section 155 must contain all information reasonably required to facilitate creditors in deciding whether to accept or reject the proposal.

The adoption of a proposal requires the support by a majority in number, representing at least 75% in value, of the creditors or class, as the case may be, present and voting in person or by proxy, at a meeting called for that purpose.

If a proposal is adopted, the company may apply to the court for an order approving the proposal, in which case certain procedural requirements will need to be complied with.

Having regard to the above compromise procedure, it must also be noted that where the company is able to pay its debts, an arrangement between the company and its creditors may be effected pursuant to section 389 of the 1973 Companies Act, which continues to apply pursuant to the provisions of item 9 of Schedule 5 of the 2008 Companies Act.

Conclusion

South African law of insolvency is relatively complex due to the inter-relationship between general insolvency law provisions, as applicable to natural persons, and those contained in the Insolvency Act, the Old Companies Act, and the regulation of further aspects of insolvency in the New Companies Act. The principles, however, are well entrenched and draw strongly from English law precedent in their origin and effect.

The interaction between and functioning of the High Court, the office of the Master of the High Court and the insolvency practitioners’ profession, from whose ranks liquidators are appointed, is also complex and in certain respects in need of reform. That is not a subject within the scope of this Guide, however.
Spain

Overview, Introduction and Legal Framework

In Spain there is a single procedure (called concurso de acreedores) in the event of the insolvency of a debtor (either an individual or a corporation). The procedure is regulated by the Spanish Insolvency Act 22/2003, dated 9 July (the “Insolvency Act”).

The purpose of the Insolvency Act had been to satisfy the various creditors’ claims whilst preventing the liquidation of the bankrupt companies, in an attempt to ensure their economic feasibility. However, after more than a decade since the entry into force of that legislation, experience has shown that it has not overcome some of the drawbacks that the current financial and economic recession has highlighted. Most proceedings (more than 90%) end up in liquidation and the vast majority of claims are left unpaid, not to mention the significant delays that are faced, due to the high workload of commercial courts. This is rather distant from the spirit of Spanish insolvency legislation, which was designed precisely to maintain companies and their production capacity.

The Insolvency Act has undergone various reforms over the last several years, though none has managed to correct this tendency. After some modifications in 2009, the Insolvency Act was globally amended by Act 38/2011, dated 10 October, effective as of 1 January 2012, in an attempt to adapt the Spanish legislation to the emerging economic and social circumstances and, in particular, to the recession environment, by offering continuity alternatives for distressed companies and businesses and by simplifying the insolvency proceedings, thus decreasing the workload of the Spanish tribunals.

The legislation was again revised by new amendments which have tried to offer pre-insolvency solutions and to make creditors’ arrangements more flexible, thus providing the debtors with more suitable refinancing and restructuring alternatives.

The first reform, effective as of 18 October 2013, was approved by Act 14/2013, dated 27 September, on support to the internationalisation of business and entrepreneurship. It implemented out-of-court solutions for minor restructuring cases (also known as “insolvency mediation”).

The second amendment came into effect on 9 March 2014, with the approval of Royal Decree-Law 4/2014, of 7 March, implementing urgent measures for the refinancing and restructuring of corporate debt. This new reform, rushed through parliament in record time, is complex and represents one of the most daring recent developments in handling bankruptcy. It seeks to work in depth on relief procedures for viable companies’ financial debt in order to avoid bankruptcy by eliminating the rigidity of the rules governing refinancing agreements. The legislation was approved following a number of insolvency cases with wide media coverage that showed the imperfections of the previous system. Royal Decree-Law 4/2014 focuses on the pre-insolvency phase (that is, the beginning of negotiations to reach a refinancing agreement or to approve of an early composition agreement), as well as the refinancing agreements and their content, requirements, effects and authorisation. This Royal Decree-Law was recently ratified by Act 17/2014, dated 30 September, which adopted urgent measures for refinancing and restructuring corporate debt, effective as of 2 October 2014.

A third amendment came into effect on 7 September 2014 with the approval of Royal Decree-Law 11/2014, dated 5 September, on urgent measures in insolvency proceedings. This reform extends the pre-insolvency solutions provided for by Royal Decree-Law 4/2014 to creditors’ arrangements that are achieved during insolvency proceedings (composition agreements). It also attempts to improve the regime of the purchase of production units and
Pre-Insolvency Alternatives to Avoid or Postpone the Application

As a general matter, the debtor, either personally or, if it is a company, through its management body, must file for insolvency within two months following the date on which the debtor's insolvency was known or should have been known.

Article 5bis: Insolvency Postponement Notice

Article 5bis of the Insolvency Act regulates an exception to the legal period to file for insolvency, by entitling distressed companies to file a "notice of postponement" (comunicación de prórroga concursal) before the commercial courts. The filing opens a three-month negotiation period either to reach a refinancing agreement with financial creditors or to obtain an anticipated adhesion to a composition agreement with creditors, thus suspending the legal period to apply for insolvency. The postponement may also be used by the debtor to find a third-party investor interested in acquiring the company or a business or production unit.

This provision tries to facilitate pre-insolvency restructuring schemes in terms similar to Italian insolvency law (through institutions such as concordato preventive and programa di ristrutturazione) and French insolvency law (regulation of sauvegarde des entreprises).

The debtor may apply for a “confidential” notice of postponement. This means that it will not be published in the Public Insolvency Registry. Before this, the broad public knowledge of pre-insolvency cases made the refinancing of companies in this early phase more difficult.

If the agreement obtained is validated (endorsed) by the court, its postponement clauses will be extended to other financial creditors. Judicial validation will be granted, subject to certain requirements, and if the agreements do not involve disproportionate damage to the estate’s assets (see “Refinancing Agreements and Their Endorsement by the Court” below). However, if a composition or a refinancing agreement is not reached within three months from the filing of the notice of postponement, and the debtor is still insolvent, it must file for insolvency within the following month. Therefore, Article 5bis grants the debtor, in practice, a protective shield of four months to compromise with its creditors or develop a restructuring plan for the company, whilst protecting the debtor from insolvency petitions filed by creditors and excluding the personal liability of its directors for delay in filing for insolvency.

Enforcements against the debtor’s assets necessary to its activity are prohibited and those under way will be stayed from the time of filing the notice of postponement, either until the agreement is formalised or, in any event, for three months after the notice is filed in court. The court handling the insolvency postponement is competent to decide whether the affected assets are necessary to the debtor’s activity.

This affects enforcement proceedings (either judicial or non-judicial) against goods which are necessary for the debtor to continue its activity (in which case it will be sufficient for the debtor to present the court ruling admitting the notice of postponement) and enforcements promoted by creditors holding financial rights of credit when the debtor verifies that it has the support of at least 51% of its financing creditors to initiate the negotiations to formalise a refinancing agreement and their express commitment not to initiate or continue enforcements.

In practice, though, the majority of postponement communications end with a voluntary insolvency filing.
In the course of an ensuing insolvency, the appointed insolvency receiver will check that the debtor used the postponement term to look for alternatives to keep its business viable. For instance, the debtor may be forced to provide the receiver with evidence, such as a binding written commitment to acquire the company or any operating productive unit, or correspondence or drafts regarding refinancing or composition agreements.

Out-of-Court Settlement Agreement of Payment of Debts

An out-of-court settlement agreement, also known as “insolvency mediation”, is a debt renegotiation mechanism which also takes place in a pre-insolvency stage, as an alternative to the abovementioned postponement. It seeks to promote out-of-court solutions for minor restructuring cases, allowing for the exoneration of debts and transfer in payment of debts in certain cases. It is designed for individual entrepreneurs, freelancers and small and medium-sized businesses that have not yet been declared insolvent and whose assets and liabilities meet certain requirements.

To initiate the procedure of out-of-court settlement of payments, the debtor submits a petition to a notary public or, if it is a company, to the commercial registrar in its place of incorporation. A new role, that of the insolvency mediator (mediador concursal), has been introduced. The insolvency mediator is appointed from a list of eligible candidates by the public notary or the registrar in charge of the file and is subject to the same requirements and prohibitions as the insolvency receiver (administrador concursal) (described below). The insolvency mediator is intended to act as an independent negotiator. He leads the procedure, thus promoting consensus among the debtor and its creditors.

Although the procedure will be processed out of court, both the court having jurisdiction and the tax authorities will be informed when it is instituted.

Like the postponement notice under Article 5bis of the Insolvency Act, the out-of-court settlement of payments extends the term during which the debtor must file for its own insolvency. During the extension, the debtor may continue to conduct its business activity, subject to certain cost-saving restrictions. No enforcement proceedings against the debtor may be initiated or continued during this term, except for those brought by secured creditors, who will need to choose between enforcement of their claim or adhesion to the settlement agreement.

The procedure is aimed to reach a binding agreement between the debtor and its creditors, with the opportunity to have up to 25% of the debt written off and a three-year payment moratorium. Most significantly, it also includes the option of accepting goods in lieu of payment (dation in payment). The out-of-court settlement of payments binds all the creditors (but for public creditors and secured creditors who opt not to adhere to the negotiation process).

The creditors are summoned to a meeting in which the approval of the proposed payment and feasibility plans will be addressed, and those not attending may have their claim degraded to subordinate status. Approval requires the favourable vote of 60% of the liabilities affected by the settlement or, in the event that goods are accepted in lieu of payment, the favourable vote of 75% of the liabilities affected, and of any creditor who has a security interest in the transferred goods.

The procedure ends when the impossibility to achieve a settlement becomes evident or if an agreement is concluded and then breached. In either case, the insolvency mediator will directly file a petition before the court having jurisdiction and request that “subsequent insolvency proceedings” (concurso consecutivo) be instituted straight into liquidation.
Insolvency Proceedings Step By Step

Application for Insolvency

Under Spanish legislation, any debtor that is (or foreseeably will be in the immediate future) unable to meet its payment obligations on a regular basis is regarded as insolvent. Case law clarifies, though, that inability to meet regular obligations occurs when the debtor fails to pay its debts to at least 15% of two different types of creditors (classified for these purposes as financial, commercial or public creditors). Insolvency may occur regardless of the debtor’s balance sheet or the value of the debtor’s assets.

An impairment situation, that is, when the debtor is facing losses that reduce its equity to an amount less than one-half of the share capital, may also result in an insolvency scenario. If a debtor confronts an impairment scenario which subsequently is determined to be an insolvency situation, the filing of insolvency proceedings has legal priority over a mere corporate liquidation or any other commercial measure provided by corporate legislation.

The debtor, either personally or, if a legal person, through its management body, must file for insolvency within two months following the date on which the insolvency was known or should have been known. Also, any creditor (except for those who have acquired claims by *inter vivos* acts and by singular title, after maturity thereof, within the six months prior to lodging the insolvency petition) may apply for its debtor’s insolvency by providing evidence of both the enforceability of its claim against the debtor and the debtor’s indebtedness situation.

When the applicant is the debtor, the following documentation must be provided within the application:

- Special power of attorney to petition for insolvency in favour of a court agent (*procurador*), which is a mandatory representative under Spanish procedural rules.

- Report stating the history of the debtor, the activity or activities performed in the last three years, the establishments, offices or operating facilities owned, the causes of the insolvency and the valuations and proposals on the viability of this situation.

- Inventory of assets and rights, stating their nature, the place where they are located, register identification data when appropriate, acquisition value, appropriate valuation corrections, and estimation of the present real value. An indication must also be given of the encumbrances, liens and charges that affect these assets and rights, stating their nature and the identifying data.

- List of creditors stating their nature and identity, as well as the amount and maturity of the respective claims and the personal or *in rem* guarantees established.

- Names of staff and the identity of the body that represents the employees, if any.

- Annual accounts (separate and consolidated) and, when appropriate, management reports or audit reports for the last three business years. Also, a report stating the operations performed with other companies of the group during that same period.

- Report on the significant changes that occurred in the debtor’s economic state following the last annual accounts drawn up and deposited and the operations that, due to their nature, object or amount, exceed the ordinary business or trading by the debtor.
Intermediate financial statements prepared after the last annual accounts presented, in the event of the debtor being bound to serve notice of these or to submit these to the supervisory authorities.

If the request for insolvency is submitted by the creditors, it may be based on a title whereby the enforcement against the debtor’s assets has been requested but not obtained; or it may be based on any of the following circumstances, as listed in Article 2(4) of the Insolvency Act:

- Total failure by the debtor to meet its payment liabilities;
- Attachments for pending executions which affect the debtor’s assets on a general basis;
- Fraudulent concealment or hasty disposal of assets by the debtor;
- General failure to fulfil the following within the three months prior to the filing of the insolvency petition: tax duties; payment of any kind of social security contributions to be made by the company; or payment of salaries, indemnities and any other compensation to employees.

Assignment of the Insolvency Case to Commercial Courts

The insolvency proceedings are heard by the Spanish Commercial Courts (Juzgados de lo Mercantil, and hereinafter, commercial or insolvency courts), which are the specialised courts in commercial matters, broadly experienced in companies' financial crises. They are the only courts with jurisdiction to decide, not only on most commercial or civil issues related to the insolvent debtor, but also on those administrative or labour matters which are directly linked to the insolvency and whose resolution is necessary for the proper development of the bankruptcy procedure.

The application and supporting documents must be submitted to the commercial courts in the capital of the province where the debtor’s “centre of main interests” or, more commonly, “COMI”, is located, that is, the place known to others from which the debtor habitually manages its activity (presumably, its registered address).

In each provincial capital, there may be one or, more commonly, various tribunals. The filed application will be assigned by rotation to one of these available tribunals, by means of computer software managed by the Regional Ministry of Justice. There are no fixed criteria for this assignment other than randomness and the fact that the tribunal which was last appointed in charge of a large insolvency case will be automatically discarded in the next “raffle”. Aspects such as the nature of the debtor’s business, the value of the insolvency liabilities or the continuity/liquidation perspectives of the petitioned bankruptcy are irrelevant for the assignment.

Court Ruling Declaring Insolvency

Once assigned, the court will examine the debtor’s application and the supporting documents and, if they are considered sufficiently thorough and insolvency is deemed to have been proven, the court will issue a ruling (auto) declaring the debtor insolvent.

By means of this ruling, the court:

- States whether the insolvency is voluntary (application filed by the debtor) or compulsory (application filed by a creditor) and, when appropriate, whether the debtor has applied for liquidation;
• States whether the system is one of intervention (the debtor's management body maintains the power to administer and dispose of its assets, subject to approval by the receiver) or revocation (these powers are assigned to the receiver). As a general rule, debtors who have applied for their own insolvency will be subject to a system of intervention (see “Effects of the Insolvency Ruling on the Debtor and its Business” below);

• Appoints the insolvency receiver;

• States whether interim injunctive relief is applicable to protect the debtor’s assets until the receiver accepts the appointment;

• States whether abbreviated proceedings are applicable (see “Abbreviated Proceedings” below);

• Specifies the publicity that is to be given to the declaration of opening the insolvency proceedings; and

• Calls for creditors to notify the receiver of their claims within one month after the publication of the court order declaring the insolvency in the Spanish Official Gazette.

An abstract of the court order is published online free of charge in the Spanish Official Gazette (Boletín Oficial del Estado), at www.boe.es and in the Insolvency Public Registry at www.publicidadconcursal.es. The latter is a new centralised insolvency information system that seeks to shore up the deficiencies of the former Public Insolvency Rulings Registry, which was in effect since 2005. The new Registry, approved by Royal Decree 892/2013, dated 15 November, makes available to any citizen a free public tool for accessing official, reliable information on all types of insolvency (and pre-insolvency) proceedings and contributes to the transparency in the disclosure and publication of these matters.

In addition, if the debtor is registered in the Commercial Registry, the insolvency ruling and details as to whether the debtor is subject to intervention or revocation of powers and the appointment of the receiver will appear in this Registry. This information is also included in any public Registry where the debtor’s assets or rights are registered.

The Insolvency Receiver: Appointment and Role

The receiver (administrador concursal) is appointed by the insolvency judge, who refers to the publicly available lists available in the Insolvency Public Registry of professionals who have expressed their availability and have proven training and expertise in insolvency matters. Neither the debtor nor its creditors may influence the decision of the insolvency judge as to which receiver is appointed. The receiver will have to appear before the court in order to accept his appointment.

The receiver must be either a lawyer or an economist, with more than five years' experience and accredited knowledge in insolvency proceedings. A company may also be appointed receiver, provided that it has, at least, both a lawyer and an economist. Exceptionally, if the insolvency has technical complexity and special significance, the court may appoint as second receiver any public administrator that is also a creditor.

For large insolvency cases, it is common that auditors, consultancy firms or boutique law firms are appointed as receivers (Deloitte for the Pescanova case; Forest Partners, ex KPMG, for the La Seda case; Mazars for the HUSA case; PwC and KPMG for the Fagor case; Deloitte for the Cacaolat case; PwC for the Spanair case; Marroquín for the Esteban Ikeda case; and Ernst & Young for the Habitat case).
The Insolvency Act provides for a series of incompatibilities and prohibitions related to the appointment of receivers. Amongst others, a person "specially related" to the debtor or a competitor (or a company belonging to a competitor group) cannot be appointed as a receiver.

The receiver is paid from the estate of the insolvent debtor, and his fees are calculated according to a fixed rate based on the number of creditors and the scale of the proceedings (small, medium or large). The criteria for the classification of insolvencies within this scale will be determined by a future regulation yet to be approved.

The role of the receiver differs depending on whether the insolvency is voluntary (where the debtor’s power to administer and dispose of its assets is subject to the receiver’s approval) or necessary (in which case the debtor’s power to administer and dispose of its assets is assigned to the receiver).

In our experience, the receiver will visit the company on a weekly basis, at this early stage of the case, to monitor payments and obligations, to obtain information for the report of the so-called common phase and to assist the managers with creditors and employees or in connection with any controversial situation under the insolvency scenario.

The receiver is liable for all damages that he may cause either to the debtor or to the creditors as a result of his negligence.

Notice by the Creditors of Their Claims against the Debtor

Once the court order is published in the Official Gazette, the creditors are granted a one-month period to report to the insolvency receiver their claims and rights of credit against the debtor, under penalty of having their claims degraded to subordinate status.

This notice is usually a simple process. The requirements are the following:

- The notice must be submitted to the receiver in writing, by letter or e-mail, either by the creditor or by a person with power to act on its behalf and need not be filed before the court;
- The notice must provide the full name, address, e-mail address and any other identification details of the creditor.
- The notice must indicate the origin, amount, acquisition date, expiration date and main characteristics of the claim, as well as the priority that this claim should merit according to the creditor (if the claim is secured, the notice must identify the security and, if applicable, any relevant registry data); and
- All documents relating to the claim must be submitted with the notice. It is not mandatory to submit the original documents or a duly certified copy of them, unless it is otherwise required by the insolvency receiver.

In any particular case, the complexity of the submission will depend on any special circumstances relating to the claim, such as a right to set-off, doubt concerning its priority, or any potential controversy regarding the existence or the amount of the claim.

Preliminary Stage: The Common Phase

The court order declaring the debtor insolvent marks the beginning of the common phase (fase común). The purpose of this preliminary stage of insolvency proceedings is to establish the circumstances in which the insolvency occurred and to determine in detail the assets and
liabilities of the insolvent debtor, by way of the report submitted by the insolvency receiver within two months from the acceptance of his appointment.

This report must contain the following:

• An analysis of the facts and circumstances of the debtor;
• The receiver’s comments on the state of the accounts of the debtor and, if appropriate, his opinion on the accounts, financial statements and reports;
• A summary of the main decisions and actions of the insolvency receiver;
• An inventory of the assets of the debtor upon the declaration of insolvency;
• A list of liabilities of the debtor upon the declaration of insolvency, which will include all the debts recognised within the insolvency proceedings; and
• An assessment regarding an early composition or winding-up proposal, when appropriate.

Once the debtor is declared insolvent, all its due debts are frozen and classified as “privileged”, “ordinary” and “subordinated” debts, in accordance with certain criteria which will affect their payment priority.

However, debts arising after the declaration of the insolvency will be treated differently and referred to as “debts owed by the debtor’s estate”. In general terms, debts owed by the debtor’s estate are those arising after the declaration of the insolvency and as a result of the debtor’s activity during the insolvency proceedings, including but not limited to salaries or compensations for employees, ordinary expenses of the business, legal advice and receiver’s fees. These debts will be paid when due, regardless of the insolvency, and thus have the highest priority in recovery (see “Payment of Creditors’ Claims” below).

The report may be challenged by the debtor or any creditor, by filing an insolvency plea within 10 days. The common phase concludes once the insolvency receiver’s final report is submitted. This happens after the period to challenge the inventory or the list of creditors expires, or after the court has ruled on all challenges.

Fork in the Road: Composition Agreement Phase vs. Winding-Up Phase

The Spanish insolvency procedure allows the debtor either to continue in business or to opt for liquidation by selling the assets and paying the creditors in the priority order provided by the law. Thus, after the common (or preliminary) phase, two possible scenarios can arise in the course of insolvency proceedings: reaching a composition agreement with creditors; or opening the winding-up (or liquidation) phase.

Whereas the first scenario assures the bankrupt company’s economic feasibility, the second one involves its liquidation and dissolution.

The Composition Agreement Phase

Once the common phase is finished, unless the debtor has requested to move directly to the winding-up (or liquidation) phase, the court will open the composition agreement phase, in which the debtor will seek to reach a composition agreement with its creditors.

The debtor may also file a proposal of early composition agreement during the initial phase of the insolvency proceedings, that is, before the termination of the common phase and,
specifically, before the expiration of the initial one-month term granted to creditors to report their rights. An early composition agreement may also be submitted within the application for voluntary insolvency, in which case the insolvency proceedings are regarded as abbreviated (see “Abbreviated Proceedings” below).

The court ruling opening the composition agreement phase will schedule a creditors’ meeting. Either the debtor or any creditors representing at least 20% of the debts may submit a proposal of composition agreement no later than 40 days before the date scheduled for that meeting.

This agreement may provide for up to 50% of the debts to be written off and/or up to a five-year payment moratorium. Exceptionally, a qualified majority of 65% of the unsecured debts may validate a discharge of more than 50%, without limit, and payment moratorium from 5 to 10 years.

After the approval of Royal Decree-Law 11/2014, dation in payment may also be included in these arrangements, and the capitalisation of debt is also favoured.

All proposals must contain a payment schedule and a feasibility plan, which must specify the resources necessary to comply with the proposal and their availability. At the creditors’ meeting, the debtor and the creditors will discuss, in the presence of the receiver and the judge, the composition agreements that have been proposed.

Creditors may provide support for the proposals either by attending the meeting and voting in favour or, prior to that, in writing, by appearing before the court clerk or in a public deed. Opting for one method or the other will have no impact on the value of each vote, which will be proportional to the amount of claims held in the insolvency proceedings by each voting creditor.

The Insolvency Act now promotes the acquisition of claims by distressed investors after the declaration of insolvency. The former regulation discouraged this kind of operation by depriving the acquirer of the claim of its voting rights, and thus affording the acquirer a very limited intervention in the insolvency proceedings. After Royal Decree-Law 11/2014, the acquirer preserves its voting rights, unless it is a person “specially related” to the debtor.

If a proposal is accepted in the creditors’ meeting by at least 50% of the ordinary creditors, the judge will issue a judgment approving the agreement, unless a defect is detected ex officio. The approval by the insolvency court may be challenged by the receiver, the creditors who did not attend the creditors’ meeting, the creditors who were illegitimately deprived of their right to vote and the creditors who voted against the adopted proposal. In case a challenge is filed, the judge will issue a judgment deciding whether the proposed agreement will be approved or dismissed.

After this judgment, the receiver will resign and all effects of the declaration of insolvency will be replaced by those specified in the composition agreement. The debtor will have to inform the judge and the creditors on a bimonthly basis about the completion of the agreement.

The former regulation attributed binding effects of the approved composition agreements only with respect to unsecured ordinary and subordinated claims. Pursuant to Royal Decree-Law 11/2014, approved arrangements, subject to a majority within each class of claims, may now bind privileged creditors, as well. Arrangements with creditors including discharges of more than 50% and postponement of up to five years will be binding on a privileged creditor when a 60% majority of the debt in that class votes in favour. These include creditors holding (1) employment-related debt, (2) debt with public entities, (3) financial debt, and (4) any other class of debt. Thus, for example, a dissenting bank holding a mortgage was not
subject to the arrangement before the reform, but now is subject if 60% of the other creditors holding financial debt support it, whether or not they hold a mortgage. Cramdowns for arrangements with discharges of less than 50% and postponements of 5 to 10 years require a supermajority of 75% of the debt in the same class.

In the event that no proposal is approved, the judge will order the initiation of the winding-up (or liquidation) phase. If a proposal is approved, however, the winding-up phase will also begin if the debtor fails to comply with the composition agreement in force.

Royal Decree-Law 11/2014 expressly allows the revision of arrangements with creditors adopted in keeping with earlier legislation if they are breached and were contrary to the new regulations. Revision is allowed within two years of the effective date of this reform and must be approved by qualified majorities.

Finally, the Insolvency Act also provides for a special procedure to approve a composition agreement if the number of creditors exceeds 300, called “written proceedings”. In such event, the court may hold that the proposed composition agreement be approved by creditors in accordance with a written procedure. Rather than attend a creditors’ meeting, the creditors provide their adhesion only by appearing before the court clerk or in a public deed.

The Winding-Up Phase

The debtor may request the initiation of the winding-up (or liquidation) phase at any moment and, specifically, during the term of a composition agreement, as soon as it becomes aware that it cannot comply with the same. The creditors are also entitled to request liquidation, should they detect any sign of insolvency during such term. In the event of termination of the debtor’s activity, the receiver may request liquidation, too. The judge will also, on his own initiative, order the liquidation phase to begin if no composition agreement is proposed or (if proposed) approved, or if the debtor breaches an approved agreement.

As a result of the court ruling opening the liquidation phase, the dissolution of the bankrupt company will be declared and its directors will be directly substituted by the receiver, who will have, from that moment, the power to manage and dispose of the debtor’s assets.

The receiver will submit within the following 15 days a winding-up plan ordering the further steps and rules regarding the liquidation of the debtor’s assets and subsequent collection by the creditors. This plan should, in principle, grant priority to the sale of the business or operating productive unit of the debtor as a whole. The debtor, the employees and the creditors are entitled to comment upon or propose amendments to the proposed plan within 10 days after the plan is submitted. The court will ultimately approve (potentially taking into account the comments or proposals made) or reject the proposed winding-up plan. If the plan is rejected, the liquidation phase will be regulated by the Insolvency Act, which also considers, essentially, the global sale of the business or operating productive unit of the debtor, when possible.

Every three months following the opening of the winding-up phase, the insolvency receiver must present a report to the court on the status of the operations, which will detail and quantify the claims against the estate accrued and pending payment, stating their maturity dates.

Payment of Creditors’ Claims

The Spanish procedure for insolvency proceedings is aimed at maximising the satisfaction of creditors, who should be treated equally under the par conditio creditorum rule (i.e. treating equally ranked creditors equally). The payment of creditors’ claims depends on whether a composition agreement is reached and approved by the judge or the liquidation phase
begins. Whereas in the composition agreement phase the debt collection will depend on the continuity of the debtor’s activity and economic revitalisation, if the liquidation phase begins, the creditors’ recovery will depend on the realisation of the debtor’s assets.

In the liquidation phase, the creditors will be paid off as established in the winding-up plan, respecting the order of priority established in the Insolvency Act:

<table>
<thead>
<tr>
<th>Claims against the entire insolvency estate (Articles 84 and 154 Insolvency Act)</th>
<th>Créditos contra la masa</th>
<th>This applies to claims generated after the issuance of the court order declaring the insolvency, expenses and costs generated during the insolvency proceedings, and certain claims owed to the debtor’s employees. These claims are paid when due.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claims with special privilege (or preference) (Articles 90 and 155 Insolvency Act)</td>
<td>Créditos con privilegio especial</td>
<td>Secured claims (mortgage, pledges, leasing quotas, etc.). The scope of the special privilege is limited. It may not exceed the value of the relevant guarantee and such value will be 9/10 of the reasonable value of the good or right in question minus the amount of the unpaid debts with preferred guaranties. In no event can it be less than zero or more than the amount of the privileged credit or the maximum agreed liability. Any other amount of the credit exceeding the limit will be classified according to its nature. Payment of claims with special preference will come from the security, subject to either separate or collective foreclosure.</td>
</tr>
<tr>
<td>Claims with general privilege (or preference) (Articles 91 and 156 Insolvency Act)</td>
<td>Créditos con privilegio general</td>
<td>Salaries and employee compensations, with certain limits; tax and social security claims; 50% of claims held by the creditor that filed for mandatory insolvency; claims arising from new cash flow granted under the framework of a refinancing agreement; etc. After deducting from the estate the assets required to settle the foregoing senior claims, payment of those enjoying general preference will be honoured, in the order established in the Insolvency Act and, when appropriate, in proportion among them within each class.</td>
</tr>
</tbody>
</table>
Ordinary claims (Articles 89(3) and 157 Insolvency Act)  
Créditos ordinarios  
This applies to all other commercial claims without special guarantees.
Payment of the ordinary claims will be carried out once the claims against the estate and preferential claims are settled, in proportion among them.

Subordinated claims (Articles 92 and 158 Insolvency Act)  
Créditos subordinados  
Claims degraded (claims of managers, directors or partners of the debtor; intra-group loans; fines; interest; claims not reported in due time; etc.).
Payment of the subordinated claims will not be performed until the ordinary claims have been fully settled.

The Insolvency Act provides the criteria for establishing the classification of each claim by the receiver. In case of a dispute between the creditor and the receiver’s report, a small and ancillary piece of litigation – insolvency plea – may be filed before the court by the concerned creditor (within the period of 10 days granted to challenge the report). A court judgment will eventually decide on the recognition and classification of the specific claim.

Abbreviated Proceedings

Abbreviated proceedings provide celerity to those cases requiring a prompt response from the tribunals when the continuity of the business is at stake. As a general rule, abbreviated proceedings are limited to cases lacking technical complexity, with fewer than 50 creditors or liabilities and assets of less than EUR 5 million. However, regardless of whether these criteria are fulfilled, abbreviated proceedings will be applied when the debtor submits along with the petition for insolvency either: (i) an early proposal of composition or a proposal of composition that includes a structural modification by which all its assets and liabilities are conveyed; or (ii) a winding-up plan that contains a binding written commitment from a third party to purchase the operating productive unit.

Liability of Third Parties: Classification of the Insolvency

For insolvency proceedings to generate liability for third parties, the insolvency must be classified as fraudulent (or culpable) rather than fortuitous. The classification plea shall be opened by the court, in a separate piece of the insolvency proceedings (pieza de calificación):

- When the court approves a composition agreement with creditors, which establishes a discharge of more than one-third of the total amount of debt or a postponement of more than three years in payment; or
- In any situation in which liquidation is required.

The Insolvency Act gives details on the instances in which liability occurs, who is to be held liable, and the effects arising from such liability. An influence from English law (with the institutions of fraudulent trading and wrongful trading) and French law (with the action du complément de passif) may be noted.
The insolvency will be classified as fraudulent when the generation or aggravation of the insolvency involves malicious intent or serious negligence on the part of the debtor or, for a legal entity, on the part of its de facto or de jure directors, liquidators, proxies or any other legal representatives (and also the individuals who held these positions up to two years prior to the declaration of insolvency).

In any case, the insolvency shall be classified as fraudulent, pursuant to Article 164 of the Insolvency Act, when any of the following circumstances arise:

- The debtor, legally obliged to keep accounting books, fails substantially to fulfil this obligation, maintains a double accounting system, or commits an irregularity in its accounting books which is relevant for the comprehension of its equity or financial situation;
- The debtor commits a serious inaccuracy in any of the documents attached to the request for the declaration of insolvency or submitted during the proceedings, or the debtor attaches or submits false documents;
- The liquidation phase is opened on the court’s initiative due to the breach of a composition agreement by the insolvent party;
- The debtor conceals all or part of its goods in detriment to its creditors or performs any act that delays, hinders, or prevents effective seizure of its goods in any type of enforcement initiated or foreseeably to be initiated;
- Goods or rights are fraudulently removed from the debtor’s equity during the two years prior to the date on which insolvency is declared; or
- The debtor performs any legal act intended to present a false image of its equity status prior to the date on which the insolvency is declared.

Supplementing the above, the existence of malicious intent or serious negligence shall be presumed, in the absence of evidence to the contrary, under Article 165 of the Insolvency Act, when the debtor (or any of the abovementioned representatives):

- Has failed to fulfil its duty to request the declaration of insolvency;
- Has failed to fulfil its duty to cooperate with the judge presiding over the insolvency proceedings and with the receiver, has failed to provide information necessary or useful to the proceedings, or has failed to attend the creditors’ assembly either in person or through a representative;
- For a debtor who is legally obliged to keep accounting books, has failed to prepare the annual accounts, to submit them to audit when required, or, once they have been approved, to deposit them with the Commercial Registry in any of the last three fiscal years prior to the declaration of insolvency.
- Has refused the capitalisation of credits with no reasonable cause, thus preventing a refinancing agreement from being approved. Capitalisation is presumed to be for a reasonable cause when so declared by an independent expert’s report.

The insolvency court will issue a judgment to decide on the classification of the insolvency.

If the insolvency is declared fraudulent (or culpable), the de facto or de jure directors, liquidators, proxies or any other legal representatives of the company (and also the
individuals who held these positions up to two years before) may be forced to pay the claims which cannot be paid out of the assets in the company’s insolvency estate. The accomplices – whoever they might be – may be also obliged to pay for the damages caused as a consequence of their involvement in the events which made the insolvency fraudulent.

The decision classifying the insolvency as culpable must contain the following pronouncements:

- The determination of the persons affected by the classification, as well as those declared accomplices. If any of the affected persons is a de facto director, liquidator or legal representative of the debtor company, the decision must give the reasons for which it deems the person to be a person affected;

- Disqualification of the persons affected by the classification as fraudulent to manage the goods of others for between 2 and 15 years, or to represent or administer any person for the same period, taking into account, in any event, the seriousness of the facts and the degree of damage caused; and

- The loss of all rights which the persons affected by the classification as fraudulent or declared accomplices have as insolvency creditors or creditors against the insolvency estate, and the obligation to return the goods or rights unduly obtained from the debtor’s equity or received from the insolvency estate, as well as to pay indemnification for the damages caused.

Completion of the Proceedings

Insolvency proceedings will terminate if any of the following circumstances occur:

- The Court of Appeal revokes the court judgment declaring the insolvency;

- The insolvency judge issues a ruling declaring that the creditors’ composition agreement has been fully complied with or the liquidation phase has been terminated;

- At any stage of the proceedings, when payment of all the claims recognised or full settlement of the creditors by any other means is verified, or the situation of insolvency no longer exists;

- At any stage of the proceedings, when the debtor’s assets are found to be insufficient to cover claims against the estate; or

- All known creditors have relinquished their claims against the debtor and the insolvency court has accepted their withdrawal.

When the debtor is an entity, in cases of conclusion of the insolvency proceedings due to winding-up or the insufficiency of assets, the judicial resolution that declares this must order the dissolution of the debtor and provide for closure of the inscription sheet on the relevant public registers, to which end the Court will issue an order containing an attestation of the final resolution.

In case new assets appear after completion, insolvency proceedings may be reopened before the same court, and they will be limited to the winding-up phase with respect to those new assets.
Effects of the Insolvency Ruling on the Debtor and its Business

The court ruling declaring the insolvency has immediate effects on the debtor and its activity.

Management Powers

In the event of voluntary insolvency, the debtor will retain the powers of management and disposal of its assets, the exercise of which shall be subject to intervention by the insolvency receiver, via his authorisation or approval.

In the case of compulsory insolvency, exercise by the debtor of the powers of management and disposal of its assets will be suspended, being substituted therein by the insolvency receiver.

Any acts that breach the foregoing limitations and have not been endorsed or confirmed by the receiver may be annulled at the receiver’s request.

Management Body

In the event the debtor is a legal person, its management body will be maintained, notwithstanding the effects on its powers of management or disposal as described above.

The insolvency receiver may attend and speak at the meeting of the management bodies and, to this end, he must be summoned in the same manner and with the same advance notice as the members of the body that is to meet. The resolutions by the meeting or assembly that may have an asset-based content, or that may be directly relevant to the insolvency, will require authorisation or confirmation by the insolvency receiver to be effective.

In practice, though, receivers are not likely to exert an excessive interference in the debtor’s decision-making, especially in the case of well-organised corporations or large businesses in which they are not expert or do not have time to dedicate a lot of resources.

In any event, the debtor’s management body is bound to appear personally before the court or the insolvency receiver as often as required to do so and to collaborate and provide information on all matters relating to the insolvency proceedings.

Business Activity

Continuation of the professional or business activity performed by the debtor will not be interrupted.

However, exceptional closure of all or part of the offices, establishments or operations held by the debtor, as well as the total or partial cessation or suspension of operations, may be ordered by the court, at the request of the receiver and after hearing the debtor and the representatives of the employees.

In case of intervention, the legal obligation of the debtor to draw up and submit the annual accounts to audit, under supervision of the insolvency receiver, will continue. In the event of suspension, this obligation equally continues, with those powers lying with the insolvency receiver.

Debts

No offsetting; no accrual of new interest; interruption of expiry periods.
Assets
With the declaration of insolvency, all assets are integrated into the insolvency estate.

Their conservation will be attended to in the manner most beneficial for the interests of the insolvency proceedings.

The assets may not be disposed of or encumbered without the court’s approval, except for acts of disposal or encumbrance (i) that the insolvency receiver considers indispensable to guarantee the feasibility of the business or cash flow needs, (ii) of assets that are not necessary for continuity of the activity (provided that the price does not significantly differ from the value assessed by the receiver), or (iii) inherent to continuation of the business activity (e.g. sale of stocks).

Judicial Claims
Joinder of civil claims filed against the debtor or its managers after the insolvency ruling with the court conducting the insolvency proceedings.

Continuation of previous claims at the same court that was processing them until the ruling is final (except for proceedings claiming damages from the debtor's directors or auditors).

Joinder of labour claims.

Arbitration procedures
Continuation of arbitrations initiated before insolvency ruling. Arbitration proceedings may also be initiated against the company declared insolvent, as long as the declaration of insolvency does not ipso facto affect the effectiveness of arbitration clauses (or mediation agreements), provided that such clauses do not block the continuity of the insolvency proceedings.

Enforcement of judgments (or awards)
Suspension of all the proceedings (including those filed by in rem creditors for at least one year), except very limited cases not affecting the continuity of business.

Bilateral contracts in force
General effectiveness; possibility of termination for breach; possibility of forced termination or forced maintenance by the court in the interest of the insolvency estate.

Sale of the Insolvent Debtor' Assets of during Insolvency Proceedings
One of the main purposes of the Insolvency Act, as declared in its preamble, is to facilitate the continuity of business and employment. This objective is combined with the goal of maximising the return to creditors. The sale of assets of the insolvency estate may be a useful way of achieving both purposes.

However, the Insolvency Act has been quite restrictive for this type of transaction in the course of insolvency proceedings. Spain has not yet developed much in the way of a distressed assets market. Recent amendments, though, are moving in the direction of opening up the legal environment to foreign traders and firms which specialise in benefitting distressed companies.

The acquisition of the debtor’s assets and the assumption of its debts within the insolvency proceedings is increasingly common, and it can be done during the common phase, the composition agreement phase or the winding-up phase.
The rights and obligations arising from contracts involved in the continuation of the professional or business activity of the production unit the termination of which has not been requested will be assigned to the purchaser with no need for the other party’s consent. The licenses and administrative authorisations involved in the continuation of the business or professional activity will be assigned, unless the intention not to subrogate has been expressly stated.

In no event will the payment of pending debts be assumed, whether they are insolvency claims or claims against the insolvency estate, unless expressly assumed.

Production units will be auctioned off. If the auction has no bidders or it is deemed more suitable for the interests of the insolvency proceedings, the judge may order a direct sale or a sale through a specialised entity, the remuneration for which will be paid against the insolvency administration’s accounts. In this case, the employee’s representatives and any interested parties will submit their evaluation of the offers presented and the judge shall award the purchase by means of a court order.

The purchaser will not automatically succeed to the debtor’s liabilities linked to the production unit, except for labour and social security liabilities, as provided in Article 149.4 of the Spanish Insolvency Act. The insolvency court, however, may exclude the debtor’s unpaid debt to its employees which accrued prior to the disposal of the unit, to the extent of the amount of salaries or severance compensation which was to be assumed by the Spanish Wage Guarantee Fund, as established in Article 33 of the Spanish Workers’ Statute. Also, under Article 155.3 of the Spanish Insolvency Act, if the purchaser acquires assets linked to a mortgage, the purchaser will subrogate to the debtor’s position as mortgagor. Aside from these exceptions, the purchaser will acquire the debtor’s production unit free of any other debts (even free of those claimed by tax authorities), as provided in the insolvency legislation and as confirmed and supported unanimously by case law doctrine.

Sale of Assets within the Common Phase

Rules on the purchase of distressed assets or operating productive units during the common phase, pursuant to Article 43 of the Insolvency Act, have been affected by the latest legal developments. This type of transaction requires court approval based on the interest of the estate on a case-by-case basis. The decision will be adopted on a discretionary basis in order to conserve assets or reduce expenses for the proceedings.

As a general rule, the price should be determined in accordance with the value included in the receiver’s report. The price might be lower, but not more than 20% less than this value for real estate assets, and 10% for movable assets.

The offer will be approved automatically if no other offers are received within 10 days thereafter. Any interested party may file against the court ruling authorising the transaction a motion to reconsider before the same judge.

Sale of Assets within the Composition Agreement Phase

In the composition agreement phase, a sale of assets of the insolvency estate may be authorised as part of the agreement proposed to creditors (convenio de asunción), pursuant to Article 100 of the Insolvency Act, which provides for the sale of whole parts of the business and operating productive units.

To obtain court authorisation for such a transaction, the debtor must submit to the court a binding commitment to the continuity of the activity, a payment plan and a business plan.
Sale of Assets within the Winding-Up Phase

In the winding-up (or liquidation) phase of the proceedings, under Articles 148 and 149 of the Insolvency Act, a sale of assets and operating production units may be considered in the winding-up plan or during the winding-up phase.

The insolvency court will establish a deadline for the submission of bids for the production unit. In deciding the award, the court will grant priority to those bids which guarantee either the continuity of the production unit and associated jobs or the payment of the maximum volume of credits, also taking into consideration any allegations filed by the receiver, the employees’ representatives or the creditors.

Labour Issues within Insolvency Proceedings

Insolvency proceedings allow restructuring measures such as lay-offs or collective modifications of working conditions, which are processed exclusively before the commercial court which has jurisdiction over the insolvency proceedings. Also, any ongoing collective redundancy procedures in companies declared insolvent will be handled by the commercial court in charge of the concerned insolvency proceedings.

The collective redundancy procedures or collective change of working conditions procedures in the insolvency proceedings starts with the petition by the company. If such petition is duly based and documented it must be supported by the receiver and also confirmed by the court through its ruling.

The scheme of collective redundancy procedures and collective change of working conditions procedures in the insolvency proceedings may be described as follows (Article 64 Insolvency Act):

- Procedural initiative: The insolvency receiver, the company, and the legal representatives of the employees have the legal standing to request the initiation of the collective redundancy procedures or collective change of working conditions procedures.

- Term of application: Application must be made after the issuance of the receiver’s report, except when it is found that delay in the application of the targeted collective measures could seriously threaten the future viability of the company or jobs or when serious damage could be caused to the employees, in which case, by demonstrating this circumstance, the petition may be made to the commercial court at any stage of the proceedings after the declaration of insolvency.

- Content of the application: The application must state and justify, where appropriate, the causes motivating the foreseen collective measures and the expected results in order to assure, where appropriate, the future viability of the company and its jobs.

- Consultation period: The judge will convene the parties to a consultation period, which will not exceed 30 calendar days.

- Incorporation of third parties for the consultation period: The legal representatives of the employees and the insolvency receiver are legally entitled to request that the commercial court summon other individuals or entities which might make up an economic unit, in order for them to participate in the consultation period. The commercial court is authorised to collect additional information from the company to determine such economic units.
Negotiation: During the consultation period, the employees’ representatives and the insolvency administration will negotiate in good faith to reach an agreement.

Agreement: The agreement will require the consent of the majority of the employees’ representatives or, where appropriate, of the majority of the members of the representative body of the employees, provided that, in both cases, they represent the majority of employees in the affected work centre(s).

Severance compensation: The agreement will include the identity of the employees affected and will establish their severance compensation, which will comply with employment legislation, unless higher severance compensations have been expressly agreed, considering all the interests affected by the insolvency proceedings. The employment legislation provides a reference framework applied in each case, according to the individual circumstances of the insolvent company.

Labour authority’s report: The court secretary will request a report by the labour authority on the proposed measures or the agreement reached. The report must be issued in 15 days, following a hearing of the insolvency administration and the employees’ representatives.

Once the judge in the insolvency proceedings receives the report or once the deadline to issue the report has elapsed, the proceedings will continue. If the report is submitted late, it may nevertheless be taken into account by the judge in the insolvency proceedings when making the relevant decision.

Court ruling: The court will render its decision on the proposed measures within five days, accepting, where appropriate, the agreement reached, unless fraud, wilful malice, abuse of right, or defective consent are detected. In such event, or if no agreement is reached, the judge will decide what action to take in accordance with employment legislation.

Appeal against the court’s decision: The insolvency receiver, the insolvent party, the employees through their representatives, and the Spanish Wage Guarantee Fund may appeal against the court’s ruling before the Labour Section of the Higher Court of Justice, under Royal Legislative Decree 2/1995, of April 7, which approved the Revised Text of the Employment Procedures Act. However, these appeals will not suspend the insolvency proceedings.

Rescission (Clawback) of Acts Detrimental to the Assets of the Insolvent Debtor

Under Article 71, the Insolvency Act regulates clawback actions (acciones de reintegración) based on certain acts of the debtor that are detrimental to the insolvency estate. This is different from the classical rescission actions under civil legislation, which are based on fraud or concealment from creditors.

The receiver (or a creditor, should the receiver not apply for the rescission within two months of the creditor’s request) may file before the insolvency court a clawback action against any act which was carried out by the debtor within two years prior to the ruling declaring the insolvency and which has been detrimental to the debtor’s assets (to the extent that it has led to a reduction of the assets, thus preventing the recovery of claims by creditors within the insolvency proceedings). Both unilateral and bilateral acts may be rescinded, including agreements, payments, extinction of obligations, etc. It should be observed that fraudulent intention is not required for rescission to proceed. Spanish commercial courts are also
rescinding acts that, though not detrimental to the assets, infringe the *par conditio creditorum* principle of distribution (i.e. treating equally ranked creditors equally).

Detriment to the assets of the debtor declared insolvent will be presumed, with no possibility of rebuttal, if the debtor did not receive any consideration in exchange for the act or agreement, or the debtor paid an obligation that was not enforceable until after the declaration of insolvency.

Additionally, there is a presumption of such detriment in any act or agreement entered into by the debtor declared insolvent with a person or company "specially related" to it during the above-mentioned two-year period, or if the debtor constitutes any *in rem* guarantee in relation to previous obligations. This presumption is *iuris tantum* and, therefore, is subject to rebuttal. In any other case, the clawback action must establish the existence of detriment to the assets of the debtor declared insolvent.

Rescission by the court will result in an obligation to return all consideration, plus interest, thus bringing the parties back as close as possible to their positions before they entered into the agreement. If reimbursement is not possible, given that the rights or assets belong to a third party that acted in good faith or whose position is protected by a public registry, the subject who contracted with the insolvent debtor will be ordered to pay the equivalent value of those rights and assets at the time of delivery, plus interest. Furthermore, should the court consider that this subject acted in bad faith, this subject would be ordered to compensate for all damages that the act in question may have caused to the assets of the estate of the debtor declared insolvent.

Under no circumstances may an act included within the ordinary course of business of the debtor be subject to rescission, provided that it has been performed under normal circumstances (i.e. at market value, for good and valuable consideration, and with no unusual provisions).

Royal Decree-Act 3/2009 included two additional cases of non-rescindable agreements: guarantees securing public claims and in favour of the Wage Guarantee Fund and refinancing agreements (*acuerdos de refinanciación*) that meet the conditions provided in the Insolvency Act, as explained below.

**Refinancing Agreements and Their Endorsement by the Court**

**Non-Rescindable Refinancing Agreements**

Pursuant to Article 71bis of the Insolvency Act, a refinancing agreement is defined as an agreement reached with a debtor prior to the declaration of insolvency for the purpose of significantly increasing available credit or modifying its obligations by means of an extension of the maturity date or the undertaking of new obligations that replace previous obligations. Nevertheless, these agreements must be based on a feasibility plan that enables the debtor to continue engaging in its business in the short and medium terms.

The risk of rescission of the refinancing agreements entered into by insolvent companies within the clawback period is now eliminated, provided that the agreement meets, as contained in Article 71bis(1), the following requirements (with respect to the acts, transactions and payments made, as well as the performance guarantees provided):

- The agreement must include the consent of creditors representing at least 60% of the debtor’s liabilities on the effective date of the refinancing agreement.

- The agreement must be accompanied by a certificate issued by the debtor’s auditor attesting that the required majority has been obtained. The certificate replaces the
previous requirement of an independent expert’s report, which now becomes optional for the debtor, thus simplifying the refinancing possibilities.

- The agreement must be executed as a public deed, including all the documents proving the fulfilment of the above requirements.

In addition, recent amendments implemented a new type of refinancing agreement, under Article 71bis(2), which despite not reaching the 60% majority required in Article 71bis(1) is equally not subject to rescission. However, the agreement must improve the debtor’s equity, allow it to overcome insolvency by restoring a positive operating fund and include the following conditions:

- The agreement must increase the proportion of assets over the proportion of liabilities.

- The current assets must be greater than the current liabilities.

- The value of the guarantees issued in favour of the creditors taking part may not exceed 90% of the value of the outstanding debt or the proportion of guarantees to outstanding debt prior to the agreement.

- The interest rate applicable to the underlying debt or the debt resulting from the agreement may not exceed the prior debt by more than one-third.

- The agreement must be executed as a public deed, including all the documents proving the fulfilment of the above requirements, and expressly recording the economic reasons justifying the acts and transactions from the economic viewpoint.

**Endorsement and Extension of Effects**

Pursuant to Additional Provision Four, judicial endorsement of a refinancing agreement may be provided by the court, at the request of the debtor or any of the contracting creditors, when it fulfils the following criteria:

- The agreement must include the consent of creditors representing at least 51% of the debtor’s financing liabilities on the effective date of the refinancing agreement.

- The agreement must be accompanied by a certificate issued by the debtor’s auditor attesting that the required majority has been obtained. The certificate replaces the previous requirement of an independent expert’s report, which now becomes optional for the debtor, thus simplifying the refinancing possibilities.

- The agreement must be executed as a public deed, including all the documents proving the fulfilment of the above requirements.

The endorsed refinancing agreement will be equally non-rescindable, despite not being supported by 60% of the debt’s liabilities contemplated under Article 71bis(1). The endorsement will be sufficient to eliminate the risk of rescission, with no need for additional quorums.

The endorsement procedure seeks to make the agreement binding on dissident and non-participating financing creditors as well. The court merely needs to verify that the above requirements are satisfied. This decision will be made on an urgent basis, within 15 days of the request, and will be published in the Public Insolvency Registry and the Spanish Official Gazette. It will take effect the following day.
The binding effects of the endorsed agreement may be extended to financing creditors that did not participate or dissented, and even to those who have an *in rem* guarantee, according to the following rules:

- Provisions of moratoriums up to five years and conversions of credits to equity loans with less than five years’ maturity will be binding on other financing creditors, provided that the agreement has the support of 60% of the financing liabilities of the debtor (and on financing creditors holding *in rem* guarantees, provided that the support reaches 65%).

- Provisions of written-off debts, moratoriums between five and ten years, capitalisations of credits and conversions of credits to equity loans with a maturity of between 5 and 10 years will be binding on other financing creditors provided that the agreement has the support of 75% of the financing liabilities of the debtor (and to financing creditors holding *in rem* guarantees, provided that the support reaches 80%).

Additionally, to encourage these kinds of agreements, Article 84(2)(11) of the Insolvency Act recognises a privilege for “fresh money” injected into the company under insolvency by third parties not related to the debtor, as a consequence of a protected refinancing agreement, in the event the debtor ends in insolvency proceedings. Hence, 50% of this “fresh money” will be qualified as a claim against the debtor’s estate, thus being payable at its due term, and the other 50% as a claim with general privilege. This 50% is being temporarily increased to 100% of the “fresh money” injected in refinancing arrangements until 2 October 2016.

**Groups of Companies**

The Insolvency Act does not define a group of companies. However, pursuant to article 42.1 of the Spanish Code of Commerce, a group exists when a company, directly or indirectly, holds or may hold control over one or several others, i.e. when several companies make up a decision-making unit. The Code of Commerce gives various circumstances in which a decision-making unit is deemed to exist.

Articles 25, 25bis and 25ter of the Insolvency Act provide detailed regulation on consolidation of insolvency proceedings for groups of companies, subsidiaries or companies with mixed assets. This consolidation is decided by the judge at the request of the insolvency receiver, the debtor or any of the creditors, and it can be done either at the very beginning of the insolvency proceedings, with a court ruling declaring the insolvency of different bankrupt companies at the same time, or afterwards, accumulating different insolvency proceedings already started.

The insolvency of all the bankrupt companies of the same group will follow a coordinated procedure, with the same receivership, although their assets and liabilities should not get confused.

**Main Issues Regarding Insolvency of Individuals**

The Insolvency Act provides that an individual may request to be declared insolvent in the same circumstances as a company. In the case of individuals, the insolvency procedure is abbreviated. The insolvency ruling produces the same effects as those for companies, as detailed above.

The debtor is entitled to claim and receive compensation for ordinary personal expenses.
The two main differences between the insolvency proceedings for individuals and those for companies are:

- The outstanding debts generally are not cancelled after the termination of the insolvency procedure. However, Spanish law has recently incorporated, subject to certain requirements, the cancellation of unsatisfied debts owed by individuals, freelance professionals and individual entrepreneurs once the insolvency proceedings with liquidation have concluded, granting these debtors the opportunity to have a fresh start in a manner similar to foreign legislation.

- Court enforcement procedures against the individual’s domicile may not be suspended by the insolvency ruling, since the domicile is not an affected element necessary for business.

Closing Remarks

The number of judicial cases has increased remarkably, and the current workload of the commercial courts affects the normal length of proceedings and is causing a significant delay in their resolution.

The majority of insolvency proceedings finish with the liquidation of the company, mostly due to the fact that debtors tend to file for insolvency too late. It could therefore be recommended to file for insolvency when it is still possible to reach a composition agreement with creditors and refinancing alternatives with financial institutions, and, if possible, in a pre-insolvency scenario, thus avoiding the risks that postponing the filing could entail.

Most amendments of the Insolvency Act have not entirely succeeded in sorting out the defects caused by the former legislation, such as the significant delays suffered by most proceedings, or in adapting the Spanish legislation to the current recession environment. However, the trend of the Spanish legislation is to invigorate the out-of-court refinancing solutions, and, most significantly, the purchase of distressed assets and operating productive units within insolvency proceedings.

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Overview and Introduction

The Swedish insolvency system mainly consists of two separate regimes: the bankruptcy rules and the company reorganisation rules. The former are applicable to both private individuals and legal persons while the latter, as indicated by the name, are merely applicable to undertakings, i.e. businesses.

Applicable Legislation

The legislation governing bankruptcy proceedings is the Bankruptcy Act (Sw: *Konkurslagen*). The legislation governing company reorganisation proceedings is the Company Reorganisation Act (Sw: *Lag om företagsrekonstruktion*).

Bankruptcy

Under Swedish bankruptcy proceedings, creditors can collectively and compulsorily take the total assets of a debtor for payment of their claims. During bankruptcy, the assets of the bankruptcy estate are taken into the possession of an administrator on behalf of the creditors.

Bankruptcy proceedings may be initiated on the debtor's own application or on the application of a creditor. The debtor shall, if proven to be insolvent following the petition, be declared bankrupt. A debtor is considered to be insolvent if it cannot pay its debts when due and this incapacity is not merely temporary.

Commencement of Bankruptcy Proceedings

The petition for bankruptcy is submitted, in writing, to the district court with jurisdiction over the debtor in actions regarding general payment obligations, i.e. in general, the district court where the debtor is domiciled. The applicant shall state and prove the circumstances whereby the court is competent, if these are not known.

If the petition is made by the debtor, the petition documents should preferably enclose a schedule, signed by the debtor, of the assets and debts of the estate, and the name and postal address of every creditor together with accounts and other documents that concern the estate. However, the debtor's assertion that it is insolvent is normally accepted, with or without providing any detail.

If the petition is made by a creditor, the creditor should in the petition provide information about its claim and the circumstances upon which it bases the claim. The creditor should also enclose the original or copies of those documents to which it wishes to refer.

As mentioned above, a debtor can only be declared bankrupt if shown to be insolvent. If the petition for bankruptcy is made by the debtor, insolvency is normally assumed and not independently tested. The Bankruptcy Act states that information from the debtor that it is insolvent shall be accepted unless there is special reason not to do so. Such special reasons can, according to the preparatory work to the Act, be that there is a difference of opinion among the representatives of a legal person regarding the question of whether the company is insolvent or not.

If the bankruptcy petition is made by the creditor, the court will make an evaluation of the debtor's financial position in order to decide if the debtor is insolvent.
The Bankruptcy Decision

In the event that a debtor’s bankruptcy petition is lodged, the court will immediately determine the petition. However, under some circumstances, the bankruptcy application of the debtor is determined at a hearing, e.g. if there are special reasons not to accept the information regarding the insolvency of the debtor.

If a creditor’s bankruptcy petition is disputed by the debtor, the court lists a hearing for determination of the petition, to be held within two weeks of the petition being submitted to the court. If prior to the hearing the debtor consents to the bankruptcy petition of a creditor, the court will immediately consider the petition.

When a decision on bankruptcy is made, the district court will decide the date for a meeting at which the debtor confirms the estate inventory under oath (a “meeting for the administration of oaths”). The court will also appoint an administrator, commonly a specialist lawyer, and summon the debtor, administrator, supervisory authority1 and creditor who presented the bankruptcy petition to the meeting for the administration of oaths. Furthermore, a public notice of the bankruptcy decision – through which other creditors are summoned to the meeting for the administration of oaths – is published immediately.

The Assets of the Bankruptcy Estate

When the bankruptcy decision has been made, the debtor may not control property belonging to the bankruptcy estate. Nor is the debtor permitted to enter into obligations which could be claimed in the bankruptcy. The bankrupt’s assets are thus taken possession of, administered and disposed of by the administrator.

The bankruptcy estate – a separate legal entity formed for the purpose of winding up the bankrupt person or entity and governed by the administrator – includes all property belonging to the debtor when the bankruptcy decision was made or that accrues to him during the bankruptcy and may be attached. The bankruptcy estate also includes property that can be brought into the estate by recovery.

Recovery means that property or payment which the debtor has distributed or made to someone else is restored or repaid to the bankruptcy estate. Such recovery may, under the Bankruptcy Act, take place in certain cases. For instance, a gift is to be annulled if it has been completed up to six months before the day upon which the petition to declare the debtor bankrupt was filed with the district court (“the day of grace”), and payment of wages, fees or pension, made up to six months before the day of grace and which obviously exceeded what could be regarded as reasonable having regard to the work performed, the profitability of the operation and circumstances in general, is to be annulled. The same goes for payment of debt to specific creditors to the detriment of other creditors or the sale or distribution of any asset below market price. As a rule of thumb, any legal action by the bankrupt company six months prior to the bankruptcy decision to the detriment of the creditors as a whole, is recoverable to the estate. If the beneficiary is related to the bankrupt entity or person, this period can be as long as five years prior to the bankruptcy.

The Administrator

The administrator’s general obligation is to have regard to the common rights and best interests of creditors and to execute all measures that promote an advantageous and expeditious winding-up of the estate.

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1 The Enforcement Authority (Sw. Kronofogdemyndigheten) acts as the supervisory authority. The supervisory authority insures that the administration of the estate is pursued appropriately, in accordance with the Swedish Bankruptcy Act and other statues. The Enforcement Authority is a Swedish governmental body that also handles debt collection, default summonses and debt restructuring.
The administrator shall initially, as soon as possible, prepare an estate inventory, in which the assets of the estate are listed at carefully estimated values. The estate inventory also contains the name and postal address of every creditor. The debtor provides prospective additional information and/or makes prospective comments on the estate inventory, and subsequently under oath confirms the estate inventory at the meeting for the administration of oaths.

Moreover, the administrator prepares, as soon as possible, a written report on the condition of the estate and the reasons for the insolvency of the debtor, as far as these can be established, and, if possible, states the point in time at which the insolvency may be assumed to have occurred. The report also contains, *inter alia*, a review of assets and debts of various kinds and information about whether there is any circumstance giving rise to a right of recovery to the bankruptcy estate. Further, the administrator is charged with the task of assessing whether the business's books and records have been diligently kept and if any criminal acts have been committed.

The administrator's duties also include selling the property of the estate and taking measures to collect outstanding claims. If the debtor conducted a business operation, the administrator may, if it is lawfully possible, continue with the operation on behalf of the bankruptcy estate to the extent that it is purposeful. This also applies if the administrator, after the business operation has been discontinued, wishes to resume the activity, all in order to be able to achieve the highest possible purchase price for the assets, e.g. by divesting a “going concern”.

The Debtor’s Obligations

A debtor has many obligations, some of them quite extensive, during bankruptcy proceedings. Below are some examples.

The debtor has a duty to provide information and to attend certain meetings during the bankruptcy. The debtor must, for instance, submit to the court, the supervisory authority, the administrator and examiners such information as they request which is of significance to the bankruptcy investigation, and is obliged to attend inventory meetings, settlement meetings and meetings to consider proposals for composition.

Moreover, the debtor may not, following the issue of the bankruptcy decision and before he has sworn an estate inventory oath – which is something a debtor is required to do at the oath administration meeting – travel abroad without the consent of the court. If later during the bankruptcy there is reason to fear that the debtor will avoid his obligations as prescribed by the Bankruptcy Act by leaving the country, he may be prohibited from travelling abroad. If the debtor changes his place of residence he must advise the administrator of where he is staying.

The Creditors’ Claims in Bankruptcy

Creditors either have priority claims or non-priority claims. Creditors’ rights of priority in the event of bankruptcy are governed by the Swedish Rights of Priority Act (Sw: *Förmånsrättslagen*).

There are two general types of priority claims: specific and general priority claims. Generally, a specific right of priority has precedence over a general right of priority and all priority claims have priority over non-priority claims, i.e. non-priority claims will not be paid at all until the priority claims have been settled.
A specific right of priority is attached to, *inter alia*:

- Maritime liens and aircraft liens;
- Pledges and rights to retain possession of personal property as security for a debt ("possessory liens");
- Security interests based upon mortgages granted in ships, or ship buildings or aircraft and reserve parts for aircraft;
- Certain claims of policyholders and other parties entitled to indemnification from an insurer; and
- Mortgages in real property.

A general right of priority is attached to, *inter alia*:

- Creditors’ costs incurred in having the debtor placed into bankruptcy;
- Employees’ claims for wages or other compensation arising from the employment; and
- Entitlements to holiday pay and holiday remuneration which have accrued prior to the filing of the petition for bankruptcy.

One of the fundamental principles of Swedish bankruptcy proceedings is that all kinds of claims are admitted, provided that they are considered enforceable in Sweden. The fact that the claim is brought by a creditor who is not in any way personally connected with Sweden, or that the claim has arisen from a transaction or event that took place in a foreign jurisdiction, are irrelevant in this respect. Accordingly, all foreign creditors are welcome to participate on the same footing as those creditors who are Swedish nationals and residents and whose claims have originated in Sweden.

Non-priority claims rarely receive payment from the bankruptcy estate. However, if non-priority claims may be assumed to obtain a distribution in the bankruptcy the court will decide that a lodging of proofs procedure shall take place in the bankruptcy. If it is decided that such a procedure is to take place, the court gives a public notice of the decision and all creditors with claims are then generally required to lodge proof in order to receive payment for their claims. The proof of claim document states the amount of the claim, if possible, and the basis of the claim. If a priority right is claimed, the creditor must also state the basis for this.

**Writing-off of Bankruptcy**

Bankruptcy proceedings can be ended through distribution; through agreement between the debtor and the creditors according to which they reach a settlement; or through the writing-off of the bankruptcy.

The court decides to write-off the bankruptcy if, *inter alia*, the court, after hearing the administrator, finds that the assets of the bankruptcy estate are not sufficient for payment of bankruptcy expenses incurred and expected and other debts that the estate has incurred. The bankruptcy may, however, not be written off before an estate inventory has been confirmed under oath and the administrator has prepared his written report on the condition of the estate and the reasons for the insolvency. Subsequent to the write-off of the bankruptcy, a bankrupt legal entity is struck from the commercial register and ceases to exist. A bankrupt individual, however, survives and so do the claims against him, subject to general statutes of limitation.
Distribution and Completion

If the bankruptcy is not written off, the money in the estate, to the extent that the funds are not utilised for payment of the bankruptcy expenses and other debts that the estate has incurred, are to be distributed to the creditors. When there is to be distribution, the administrator prepares a proposal for distribution, in which he takes all claims and priorities into account.

The distribution proposal shall be kept available at the court and the supervisory authority for those persons who wish to review the documents. A person wishing to raise an objection to the distribution proposal shall do so at the court not later than the date decided by the court. When the period for raising an objection has expired, the court shall determine the distribution in the bankruptcy in accordance with the distribution proposal, unless by raising an objection or by other means, it is indicated that an error or inadequacy exists which affects someone’s rights.

When the decision to confirm the distribution and the decision to decide the administrator’s fees have gained legal force, the administrator must, as soon as possible, send the funds allocated to the creditors.

A bankruptcy is considered complete when the district court has confirmed distribution. If funds become available for distribution after the distribution proposal has been prepared, the administrator shall, through post-distribution payments, distribute them to the creditors.

Company Reorganisation

The Company Reorganisation Act provides an alternative insolvency procedure, which, as opposed to bankruptcy proceedings, does not entail that the owners and management lose control over the company and/or its assets. A business which has difficulty fulfilling payment obligations may, pursuant to the Company Reorganisation Act and following an order by a court, commence specific company reorganisation proceedings in order to reorganise its business.

Through a company reorganisation, an administrator appointed by the court shall investigate whether the business which the debtor is operating is capable of continuing, in whole or in part, and if so, the manner in which such can take place and whether there exists a possibility for the debtor to reach a financial agreement with its creditors (a “composition”).

Commencement of Company Reorganisation

An application for a company reorganisation may be submitted by the debtor or by a creditor. However, a creditor’s application will only be granted where the debtor consents thereto.

The application is submitted in writing to the district court with jurisdiction over the debtor in actions regarding general payment obligations, i.e. in general the district court where the debtor is domiciled.

An application by a debtor must contain a brief account of the debtor’s finances and the reasons for the payment difficulties, a schedule of creditors, a statement regarding the manner in which the debtor believes the business should be operated and how an agreement can be reached with the creditors, as well as a nomination of an administrator. An application by a creditor must contain information regarding the creditor’s claim against the debtor, information regarding the debtor’s difficulties in fulfilling payment obligations and a nomination of an administrator.
Two conditions must be fulfilled to obtain an order for a company reorganisation. First, the debtor must be deemed to be unable to make payment of its debts as they become due or it is likely that such inability will exist within a short time. In other words, there must be a lack of liquidity or a risk of future lack of liquidity. Furthermore, there must be reasonable cause to assume that the purpose of a company reorganisation can be achieved. In this regard, the court does not carry out any detailed assessment: rather, the aim is to prevent abuse where the conditions for a successful company reorganisation do not exist. The assessment is thus of a more general and formal nature.

Where an application is accepted for consideration, the court shall immediately adjudicate the matter. Upon the approval of an application, the court appoints an administrator.

The Administrator

The administrator must enjoy the confidence of the creditors and meet exacting qualification requirements. The legislature imposes upon the administrator a great deal of responsibility and independence. The administrator conducts the work alongside the debtor but has sole discretion on a number of issues. In the absence of consent by the administrator, the debtor may, for example, not pay debts which arose prior to the order regarding company reorganisation, provide security for such debts, or incur new obligations.

The Company Reorganisation Act states that the debtor must comply with the administrator’s instructions regarding the manner in which the business is to be conducted. In practice, however, the administrator’s work will be focused on the measures aimed at implementing the reorganisation, primarily negotiations with creditors, and certain structural issues. The administrator’s directions normally do not cover the day-to-day business since the administrator rarely holds any specific industry experience. The company’s management thus normally continues to attend to the day-to-day management of the company’s business, albeit under the supervision of the administrator.

Suspension of Payments

The debtor normally suspends its payments prior to, or in connection with, the filing of an application for a company reorganisation order. The principal reason for the decision to suspend payments prior to the application is to stop the flow of funds from the company; however, this also acts as a means of countering pressure from creditors. Payment to specific creditors might be deemed to constitute a sanctionable preference with respect to such creditors, which can thus be avoided through a suspension of payments.

Through the court’s company reorganisation order, the debtor is in practice precluded from paying debts which arose before the order was issued, irrespective of whether such debts are prioritised or non-prioritised. This follows from the fact that the debtor needs the administrator’s consent in order to pay such debts, along with the fact that the administrator may consent to such a payment only where special cause exists. Such special cause could, according to the preparatory works to the Company Reorganisation Act, for instance, be if non-payment endangers the completion of the company reorganisation procedure.

After the suspension of payments has been implemented, deliveries of goods and services are paid for in cash. “Cash” means, in practice, that no new indebtedness may arise to, for example, trade creditors. The intention is thereby to prevent the debtor from increasing its debt burden.

Protection during Administration

As a consequence of the court’s decision to start the company reorganisation, the debtor obtains protection from an array of threats as long as the procedure subsists. The debtor
thereby obtains breathing space in order to plan how to resolve the crisis. It may be said that
the debtor benefits from a “protecting veil” during the reorganisation. Two of the most
important consequences are that the debtor’s contracts may not be terminated due to
demonstrated or anticipated payment difficulties and that the debtor is protected against
actions by the company’s creditors since enforcement measures, including petition for
bankruptcy, cannot be initiated against the debtor during the procedure.

Composition

A company reorganisation is often aimed at achieving a composition. The district court may,
upon the debtor’s written request, decide to initiate composition negotiations with the
creditors. If the district court initiates such negotiations it must immediately arrange a
meeting to which the debtor, administrator and all creditors shall be summoned to appear.

Composition negotiations only concern creditors with claims originating before the
application for company reorganisation. Furthermore, creditors who can settle their claims
through set-offs or who have claims subject to rights of priority may not participate in the
composition negotiations. A creditor may participate even though its claim is not due or if it is
conditioned.

The composition agreement gives equally entitled creditors the same rights and at least 25% of
the amount of their respective claims. Agreed compositions are paid within one year
unless agreed otherwise. The composition has to be seconded by a certain percentage of
the creditors. For instance, a composition proposal which yields at least 50% of the amount
of the claim is deemed to be accepted by the creditors where three-fifths of the creditors
voting have accepted the proposal and their claims amount to three-fifths of the total amount
of claims held by creditors entitled to vote. A settled composition binds all creditors, known
or unknown, who had the right to participate in the composition negotiations.

Termination of Company Reorganisation

The court must order that the company reorganisation terminate, where, inter alia, such
measures have been executed that the purpose of the company reorganisation may be
deemed to have been achieved, or the administrator or a creditor so requests and the
purpose of the company reorganisation cannot be deemed to be achieved.

It is assumed that the formal procedure will be concluded within three months and the court
will, three months after the date of the order in respect of company reorganisation, order that
the company reorganisation terminates. Where special cause exists, the court may prolong
the period of the reorganisation. However, a company reorganisation may not proceed for a
period longer than a total of one year, in the absence of composition proceedings.

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Switzerland

Overview and Introduction

A number of Swiss laws contain rules applicable to the restructuring and insolvency of companies, ranging from corporate directors’ duties to formal bankruptcy proceedings. In particular, for the two most popular corporate forms offered by Swiss law, namely the corporation (Aktiengesellschaft, AG) and the limited liability company (Gesellschaft mit beschränkter Haftung, GmbH), the Swiss Code of Obligations ("CO") contains various rules regarding private restructuring measures involving creditors or owners, i.e. the shareholders of a corporation or the quotaholders of a limited liability company. The formal, mainly administrative and court-based, insolvency and bankruptcy procedure is regulated in the Swiss Debt Enforcement and Bankruptcy Act (the “Bankruptcy Act”). The Bankruptcy Act mainly regulates debt enforcement (regarding claims in money) and insolvency procedures against private individuals and legal entities, and sets out the procedure for enforcing collaterals. It further contains rules for composition procedures and agreements. Special rules apply to the financial sector with bankruptcy rules contained in the relevant Swiss banking acts. Insolvency and bankruptcy involving cross-border issues are dealt with in the Swiss Federal Act on Private International Law. Finally, criminal law provisions deal with criminal acts such as fraudulent bankruptcy or the disposition of seized assets.

Restructuring and Liquidation

Liquidation or Restructuring?

Solvent Liquidation

A Swiss company can be liquidated at any time by a qualified resolution of its owners. For corporations, this requires at least two-thirds of all shares represented at the shareholders’ meeting which in addition represent more than 50% of the nominal value of the represented shares. For limited liability companies, such a resolution requires the approval of at least two-thirds of the votes represented at the quotaholders’ meeting and an absolute majority of the entire nominal capital in respect of which a right to vote may be exercised. If the qualified resolution passes, a liquidator is appointed to prepare the final balance sheet, call for the filing of claims and distribute the net assets before the company is dissolved and cancelled in the commercial register.

If the company is to be dissolved without liquidation by means of a merger (or demerger), the approval of the aforementioned qualified majority likewise is required. If one of the companies is over-indebted or has a loss of capital, the other company must have freely distributable equity in the relevant amount.

Compulsory Liquidation

A company is liquidated as a consequence of bankruptcy proceedings. Bankruptcy proceedings are initiated either by creditors or by the company itself upon the determination of over-indebtedness. Furthermore, certain forms of composition proceedings can lead to the liquidation of the companies, as explained below.

Financial Restructuring

Insolvency does not necessarily lead to the liquidation of the company: the company and its creditors may find ways to restructure the company. Restructuring may be achieved by means of internal business measures, private arrangements with creditors or recapitalisation through investors, or alternatively by means of a composition procedure involving the appointment of a commissioner, as well as court approval.
Duties of the Directors

In General

The directors of the company (i.e. the board of directors of a corporation and the managing directors of a limited liability company) are charged with the overall management of the company. As such, the directors are obliged to supervise the financial situation of the company, i.e. to implement an adequate system for accounting, financial planning and control, and to take all measures necessary to ensure the company’s liquidity and financial stability as required by the specific financial situation of the company. The directors may become personally liable for violations of their duties.

Early Intervention

If the directors establish early enough that the company may encounter financial difficulties, the restructuring process may be limited to business decisions such as measures to increase business profitability, or corporate restructurings and accounting measures. The management may decide to raise capital from investors or negotiate private arrangements with creditors.

In case of loss of capital – i.e. if the balance sheet shows that half of the nominal capital and the statutory reserves are no longer covered by the assets – the directors are obliged to propose reorganisation measures to the company’s general assembly.

Over-Indebtedness and Bankruptcy Proceedings

The balance sheet may show that the claims of the company’s creditors are no longer covered, i.e. that the company is over-indebted. If this is the case, based on going-concern as well as on liquidation values, the directors are obliged to notify the court. According to case law, however, such notification need not be made where there is a substantiated likelihood for restructuring within a period of four to six weeks, or in case certain creditors subordinate their claims. Under these circumstances, the directors may then negotiate private restructuring measures with creditors.

If these conditions are not met, however, the court will open bankruptcy proceedings following the directors’ notification. The judge may grant a postponement of bankruptcy proceedings upon specific application by the directors under the condition that there are substantiated chances for restructuring. During the postponement period, the company’s management may then negotiate private restructuring measures with creditors. If needed, the judge may appoint a commissioner for the time of the postponement, although in practice this measure is rarely used.

Alternative Solution: Composition Proceedings

The company may also apply for composition proceedings. In such cases, the court may rule for a moratorium of up to two years. During such time the company may, under the supervision of a commissioner, negotiate restructuring measures with its creditors. Subject to court approval, such a composition agreement is binding for all creditors. However, if the court concludes that there is obviously no chance for a successful restructuring, it will open formal bankruptcy proceedings according to the Bankruptcy Act, which will lead to the liquidation of all assets and receivables and the dissolution of the company.

Private Reorganisation and Restructuring

Apart from normal business measures, Swiss commercial and corporate law offers a wide range of instruments to address liquidity problems. These include recapitalisation measures...
involving investors and creditors. An overview of available mechanisms (highlighting the limits of such options) is given below.

Recapitalisation by Owners

Reduction of Nominal Capital: A normal reduction of nominal capital (i.e. for corporations the share capital and for limited liability companies the nominal capital) only serves to adjust the nominal capital amount to the actual amount of equity. Thus, financial restructuring is only achieved if a reduction of nominal capital is combined with a capital increase or capital contribution.

Capital Increase: A capital increase generally only leads to a solid financial restructuring of the company if it is funded in cash (as opposed to a contribution in kind). The existing owners’ pre-emptive rights regarding the newly issued participations (i.e. for a corporation, the shares, and for a limited liability company, the quota) may be withdrawn for the benefit of a new investor.

Changes to the nominal capital generally require the approval of a simple majority of owners. For corporations, a qualified majority of at least two-thirds of all shares represented at the shareholders’ meeting which in addition represent more than 50% of the nominal value of the represented shares is, however, necessary if the pre-emptive rights of shareholders are withdrawn or the capital increase is funded by contributions in kind or made to fund acquisitions in kind. For limited liability companies, all increases of nominal capital require the approval of at least two-thirds of the votes represented at the quotaholders’ meeting and an absolute majority of the entire nominal capital in respect of which a right to vote may be exercised. The by-laws of the company can require higher percentages.

Recapitalisation by Financial Creditors

Financial creditors may be motivated to approve private restructuring arrangements if they assess that in a successful private restructuring their loss would be smaller than in composition or bankruptcy proceedings. Thus, companies often issue a plan outlining proposed restructuring measures for approval by all financial creditors. For the duration of such measures, the company and its financial creditors often also enter into a standstill arrangement. Restructuring solutions may include the following.

Bridge Loans

Bridge loans provide liquidity to the company to continue business operations during restructuring periods and are often crucial to the company’s survival. There is, however, uncertainty as to the legality of a repayment of such loans immediately prior to the opening of bankruptcy proceedings. More specifically, there is a risk that once the company has entered bankruptcy proceedings, actions may be brought by other creditors or the bankruptcy administration to declare such repayment void due to the disadvantage incurred by other creditors (actiones paulianae). In order to ensure the full and lawful repayment of a bridge loan prior to the opening of bankruptcy proceedings, bridge loans are generally secured and the company must ensure that all proceeds of the loan are used solely to pay off the company’s accounts payable, but not financial indebtedness.

Subordination of Claims

Creditors may subordinate their claims in such a way that they shall be payable (in full or in part) only once all other creditors have been fully repaid. Although such arrangements do not alter a state of over-indebtedness, this measure will allow the directors to avoid a court filing for bankruptcy.
Debt-equity Swaps

In order to decrease debt, a company may move for a capital increase where the participations are paid in by way of setting off creditors’ claims. There is a doctrinal controversy regarding the extent to which such debt may be regarded as a valid contribution to the nominal capital. While one view holds that the full nominal value of the debt may be considered as a valid contribution to the nominal capital, the other view suggests that only the market value of such debt may be set off against the claim to pay in the nominal capital. In the absence of clear case law, the risk remains that an additional contribution equal to the difference between the nominal value and the market value of the debt has to be made.

In cases involving a corporation, debt-equity swaps may be agreed with lenders in advance. In this case, the corporation will, at the time of entering into the loan agreement, issue conditional share capital. This conditional share capital is automatically triggered at the time specified, at which point the loan repayment sum is set off against the amount to be paid in for the shares. As Swiss law does not provide a mechanism to issue conditional nominal capital for limited liability companies, any debt-equity swaps involving limited liability companies can only be effected through a regular increase of the nominal capital.

Debt-asset Swaps

A company may also swap debt for assets. While market sales of assets to obtain liquidity may prove to be difficult or involve high transaction costs, creditors may be willing to purchase assets on preferential terms. Since such transactions provide advantages to the respective creditors, they may be declared void by the court upon an action filed by creditors or the bankruptcy administration once bankruptcy proceedings are initiated.

Waiver of Claims

As a last resort, creditors may agree to a full or partial waiver of their claims in order to prevent the company’s bankruptcy.

Characteristics of Private Restructuring Measures

In general, private restructuring measures do not involve administrative or court proceedings. As set out above, the measures require the approval of the company’s financial creditors or its owners. If unsuccessful, however, private restructuring measures will be followed by formal bankruptcy or composition proceedings. While these measures may be helpful in providing financial stability, some bear the risk of being deemed void, or even of civil or criminal liability both for the company and its managers.

Formal Bankruptcy Proceedings

Initiation of Bankruptcy Proceedings

As set out above, a company may file for its own bankruptcy. This applies to legal entities upon determination of insolvency or over-indebtedness, if the directors do not succeed in negotiating private restructuring measures or composition agreements.

Bankruptcy proceedings may also be initiated by a creditor. A creditor may file an enforcement request with the competent debt enforcement office regarding a claim against the company. If the claim is not paid or successfully contested in court, the competent bankruptcy court will (after a warning) open bankruptcy proceedings against the company. The court must notify the bankruptcy office as well as the commercial and land registers.
Effects of Bankruptcy Proceedings

Effects on the debtor’s assets: All seizable assets and receivables owned by the debtor at the time of the opening of the bankruptcy proceedings form the bankrupt estate. Actions for adherence may be filed to include disputed assets or receivables of the debtor. The debtor loses the capacity to dispose of the assets in the bankrupt estate. The bankrupt estate is deemed a legal entity whose rights are represented by the bankruptcy administrator. All other enforcement proceedings against the debtor cease, and new proceedings may only be initiated against the bankrupt estate.

Effects of the bankruptcy on creditors’ rights: All obligations of the debtor become due against the bankrupt estate, and all claims whose object is not a sum of money are converted into monetary claims of corresponding value. The bankruptcy office draws up an inventory of the bankrupt estate and informs the creditors of the company by way of public announcements. Depending on the size and the complexity of the estate, the bankruptcy administrator may decide to proceed with ordinary or summary proceedings, or to discontinue proceedings where there is a lack of funds. The bankruptcy proceedings are coordinated by the bankruptcy administration, which is provided for by the cantonal authorities. At the first meeting of all creditors, however, the cantonal authorities’ representatives may be replaced by a private bankruptcy administration and a supervisory creditors’ committee.

Maintenance and Clarification of the Bankrupt Estate

Civil court proceedings can be initiated to determine the scope of the bankrupt estate, for example if third parties claim ownership or other prevailing rights regarding inventoried assets. Conversely, the bankruptcy administration may claim that certain assets of third parties should be included in the estate.

Furthermore, the bankruptcy administration can commence proceedings against third parties to declare void certain transactions that were made prior to the opening of bankruptcy proceedings – for example, if they were preferential to certain creditors to the detriment of others.

Claims of the bankrupt estate can lead to lengthy (and possibly unsuccessful) court procedures. Therefore, the bankruptcy administration and the creditors may assign contested claims to certain creditors willing to take the risk of enforcing those claims. The proceeds that the respective assignees gain from their efforts will be used to cover their personal claims, whilst any surplus is handed over to the bankrupt estate.

Realisation and Distribution of the Estate, and Dissolution of the Company

Once the content of the estate is clarified, all assets are realised by way of public auction, unless the creditors, in a second meeting, decide to sell assets privately. Costs and expenses of the proceedings are paid beforehand. These include any agreements the company entered into or prolonged after the opening of bankruptcy proceedings, such as rental agreements for offices or storage facilities, as well as the costs of employees who continued to work after the opening of bankruptcy proceedings.

Secured claims are satisfied with the proceeds from the respective collateral. The remainder belongs to the bankrupt estate. All unsecured claims are satisfied according to their rank. Claims of employees as well as certain claims of insured persons are prioritised. All other unsecured claims are satisfied subsequently.
Upon the distribution of all proceeds and the final court approval of the closure of the bankruptcy proceedings, the company is dissolved and consequentially cancelled in the commercial register.

**Composition Proceedings and Agreements**

**Initiation of Proceedings and Effects of the Moratorium**

Composition proceedings are primarily aimed at the financial restructuring of the company, but in certain forms also lead to the dissolution of the company. The balance between restructuring the company and satisfying its creditors is reflected in the composition agreement. Unlike in bankruptcy proceedings, the main decisions regarding the procedure and outcome of the restructuring are taken not by administrative authorities or courts, but by the creditors, based on negotiations with the debtor.

Composition proceedings may be initiated by the debtor itself, by certain creditors or by the bankruptcy court. The composition proceedings begin with a provisional moratorium as a first instrument of creditor protection. The total duration of the provisional moratorium may, in any case, not exceed four months. Though the provisional moratorium is not granted automatically, but only by court decision, new provisions have been introduced recently to facilitate and accelerate the approval of provisional moratoriums. Further, the composition courts may adapt the terms of the provisional moratorium to the particularities of each case, for example by abstaining from appointing a provisional commissioner or from publishing the approval of the provisional moratorium. After determining that there are prospects for recovery, the court will set a fixed moratorium for a period of four to six months (which can be extended in complex cases up to a maximum period of two years) to allow for the negotiation of the composition agreement. The court also appoints a commissioner to supervise the business during the fixed moratorium period.

During the moratorium period, enforcement proceedings against the debtor may neither be continued nor initiated. Also, any interest on claims that are not secured by collateral ceases to accrue against the debtor. The debtor may continue its business under the supervision of the commissioner. The court may decide on the extent of the commissioner’s involvement. By law, however, certain transactions require approval by the composition court or, if appointed, the creditor committee.

Neither a provisional moratorium nor a fixed moratorium necessarily results in a composition agreement or bankruptcy proceedings. Should the private financial restructuring measures succeed without a formal composition agreement being necessary, for example through an arrangement between the debtor and its (main) creditors or through other financial restructuring measures, the moratorium may be lifted by the composition court without further measures.

**Content of the Composition Agreement**

Upon his appointment, the commissioner draws up an inventory of the debtor’s assets, publishes an announcement to all creditors to file their claims and drafts the composition agreement which is then negotiated with the creditors. As soon as a draft composition agreement is prepared, the commissioner convokes a meeting of the creditors. At the meeting, the commissioner informs about the financial situation of the debtor and submits the draft composition agreement to the creditors for approval by signature. A composition agreement determines to what extent the creditors waive their claims, and when and how the debtor fulfils its (remaining) obligations. The Bankruptcy Act provides for different types of composition agreements. In practice, however, a composition agreement usually combines the aspects listed below to the extent required by the specific situation.
Composition Agreement with Extension of Payment Terms: Such agreements contain provisions to extend the payment terms of the outstanding claims. In such cases, the debtor agrees to pay all claims in full, based upon an adjusted time schedule.

Composition Agreement with Partial Waiver: The creditors may agree to a partial waiver of their claims.

Composition Agreement with Assignment of Assets: A composition agreement may provide for all or part of the debtor’s assets to be assigned to the creditors or a third party. Since this type of composition agreement leads to the dissolution of the company, the applicable proceedings are similar to bankruptcy proceedings.

Creditors’ Approval, Court Confirmation and Effects

The composition agreement generally requires the consent of a qualified majority of the creditors. Once approved by the creditors, the commissioner files the agreement with the composition court for final approval upon which the composition agreement becomes binding for all creditors. However, in case of composition agreements with extension of payment terms or with partial waiver, the agreements may be approved by the court and thus, be declared applicable to all creditors of the debtor, only if the owners of the debtor have made an adequate contribution to the financial restructuring of the debtor in addition to and apart from the contribution of the creditors. With the court’s approval, the enforcement proceedings initiated against the debtor prior to the moratorium and stayed during the moratorium are terminated (with the exception of enforcement proceedings against collateral).

In case of financial institutions that are relevant to the Swiss economy or the Swiss financial system as a whole, the Swiss Financial Market Supervisory Authority ("FINMA") may approve the composition agreement even without the creditors’ consent. FINMA’s approval is subject to the condition that the agreement represents a reasonable solution regarding both the satisfaction of the creditors and the restructuring of the debtor.

If the composition agreement provides for assets to be assigned, the debtor loses the capacity to dispose of such assets at the time of confirmation of the agreement. The sale of such assets may be organised as the liquidator and the creditor committee see fit. If all assets are assigned and the company thus liquidated, the company is cancelled in the commercial register.

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Taiwan Overview and Introduction

Taiwan, the Republic of China (“ROC”), has a codified system of laws. The major codes are the Civil Code, the Criminal Code, the Civil Procedure Code and the Criminal Procedure Code. The content of the codes is drawn from the laws of other countries with similar codified systems, e.g. Germany and Japan, and from traditional Chinese laws. The supreme law of Taiwan is its constitution.

The judicial system is composed of three tiers: the Supreme Court, the High Court and the District Court. Judges decide all cases and there is no provision for jury trials.

In Taiwan, insolvency denotes a state in which a debtor is unable to meet its debts when the debts are due.

Applicable Legislation

There are several mechanisms dealing with insolvency. Articles 282 to 314 of the Taiwan Company Law provide for court-supervised restructuring of potentially viable but insolvent companies. Under the Taiwan Bankruptcy Law, a debtor could be adjudicated bankrupt upon a petition either by the debtor or a creditor when the debtor is unable to repay its debts. If the court declares to cease the reorganisation process of a corporate body, in case the conditions for bankruptcy are met, the court may, ex officio, render a ruling to declare the company bankrupt.

While the Taiwan Bankruptcy Law is also applicable to the bankruptcy of an individual, the Consumer Insolvency Procedure Act (the “CIPA”) deals with insolvency proceedings for an individual debtor with no business activities or a monthly sales turnaround below TWD 200,000 for five years.

Personal Bankruptcy

Under the Taiwan Bankruptcy Law, individual debtors can be adjudicated bankrupt upon petition by either the debtor or a creditor when the debtor is unable to repay all debts. A debtor who has ceased to make repayments shall be presumed as being unable to pay his debt. Under the interpretation of the court judgments, the definition of “unable to pay his debt” means the debtor’s total debts exceed the total assets. Per the court’s interpretation, in addition to the requirement dealing with one’s inability to settle his debts, there are two more requirements for being declared bankrupt: one, that he has certain assets with which to form a bankruptcy estate and the other, that he owes more than one creditor. Given the above requirements, only a few individuals have so far been declared bankrupt by Taiwan courts.

The CIPA establishes a scheme under which individuals plagued by overdue loans may discharge their debts and improve their financial standing by adjusting their relationship with their creditors. The CIPA allows the debtors to go to court and negotiate a repayment plan with creditors through a binary system of rehabilitation and liquidation procedures.

Eligible Debtors under the CIPA

To be eligible to apply for the CIPA, a debtor needs to meet the following criteria:

- He must never engage in any business activities, or his business monthly sales turnaround is below TWD 200,000 for five years; and
- He is unable, or in danger of being unable, to repay his debts.
Debtors are not eligible to apply for the CIPA under the following circumstances:

- Before the CIPA was enacted (11 April 2008), the debtor successfully negotiated with his creditor banks in accordance with the negotiation mechanism for unsecured consumer loans conducted by the Members of Bankers Association of ROC, unless the debtor had difficulty in performing the negotiated plan through no fault of the debtor.

- After the CIPA was enacted, the debtor successfully negotiated or mediated with his creditor banks in accordance with the CIPA, unless the debtor had difficulty in performing the negotiated plan through no fault of the debtor.

Methods of Debt Clearance

Prerequisite Negotiation

In the case of loans granted by financial institutions, including consumption loans, self-use residence loans, credit card loans or cash card loans, the debtor requests his largest creditor bank in writing for negotiation before he files for rehabilitation or liquidation under the CIPA.

The debt repayment plan that is successfully negotiated with the financial institutions and approved by the court by issuing a ruling can be a title of execution, upon which the financial institutions are entitled to seek compulsory execution if the debtor fails to perform the debt repayment plan.

Rehabilitation

Qualified loans are unsecured or non-preferential consumer loans in an amount less than TWD 12 million.

The debtor proposes a rehabilitation plan that should include repayment in instalments at least every quarter and a rehabilitation term of up to six years, or eight years in exceptional cases. The “exceptional cases” are specified to include: (1) where there are special terms of self-use residence loans in the rehabilitation plan, (2) where the debtor enters into repayment agreements with other secured or preferential creditors, or (3) where the debtor endeavours to make the statutory minimum repayment amounts. When necessary, the debtor may request assistance in preparing the rehabilitation plan from the local government agencies.

Adoption of the Rehabilitation Plan

The rehabilitation plan is adopted at a creditors’ meeting.

If the debtor receives a regular salary, practice income or any regular compensation income, and if based on the debtor’s income and financial status it can be determined that the debtor has made efforts to repay the debts through the rehabilitation plan, the court shall rule to adopt the rehabilitation plan. The court shall also rule to adopt the rehabilitation plan even when the debtor receives no regular compensation income if there is a guarantor, a person who provides security or another person who is jointly liable for the debts and the court finds the proposed rehabilitation plan is fair.

If the debtor fully performs and completes the rehabilitation plan, the unpaid portion of the debts that have been filed with court and the debts that are not filed with the court are extinguished.
If the debtor fails to perform the rehabilitation plan, the creditors may use the rehabilitation plan as the title of execution to enable them to apply to the court for compulsory execution thereof. The court may, on the application of the debtor, render a ruling to start the liquidation procedure.

If the debtor has difficulty in adhering to the rehabilitation plan through no fault of his own, the court may, at the application of the debtor, rule to extend the rehabilitation plan for less than two years. It is presumed that the debtor has difficulty in adhering to the rehabilitation plan through no fault of his own when the balance of the debtor’s disposable income less all necessary living expenses of the debtor and the persons the debtor is legally obligated to provide for is less than the monthly amount payable under the rehabilitation plan for more than three consecutive months. If an extension is impossible, the court may rule to discharge the outstanding debts if the debtor has repaid three-quarters thereof according to the plan and if the unsecured and non-preferential creditors have been paid more than they would have been paid in a liquidation procedure. This does not apply to the debts covered by the special terms for the self-use residence loans in the rehabilitation plan.

**Liquidation**

If the rehabilitation plan is not approved by the creditors at their meeting or if the debtor is unable to pay his debts, the court may rule to start the liquidation procedure on the debtor’s application.

Upon termination or completion of the liquidation procedure, the court issues a ruling to discharge the debtor’s liability. Such ruling can be revoked within one year if the debtor is found to have concealed his assets or has engaged in any dishonest behaviour in order to obtain the ruling.

If the debtor has salary income, practice income or any other sources of regular income, and if the repayments paid to the unsecured or non-preferential creditors are too low in light of the debtor’s disposable income for the two years before the debtor filed for liquidation, the court issues a ruling not to discharge the debtor’s liability. However, after issuance of such ruling, if the debtor continues to repay his creditors to the extent that the unsecured or non-preferential creditors receive an amount equal to what they would have been paid in a liquidation procedure, the debtor may apply to the court for a ruling that discharges his liability.

Unless otherwise unanimously agreed to by the unsecured and non-preferential creditors, the court rules not to discharge the debtor’s liability if the debtor has already been discharged according to the Taiwan Bankruptcy Law or this CIPA during the past seven years, or if the debtor has been found to have committed dishonesty in order to damage the liquidated assets or circumvent the CIPA.

After the issuance of a ruling not to discharge his liability, if the debtor continues to repay his debts to the extent that every unsecured and non-preferential creditor is paid up to 20% of its debt amount, the court may, on the debtor’s application, issue a ruling to discharge the debtor’s liability.

**Corporate Restructuring and Insolvency**

**Reorganisations, Restructurings and Work-Outs**

Articles 282 to 314 of the Taiwan Company Law provide for court-supervised restructuring of potentially viable but insolvent companies. The corporate reorganisation is intended to assist potentially viable companies to generate sufficient cash flow to meet their debts.
Reorganisation is applicable only to publicly held companies or companies issuing corporate bonds. Reorganisation begins by filing a petition with the District Court with jurisdiction over the registered office of the company that is the subject of the reorganisation. The petition of reorganisation can be filed by any of the following interested parties:

- The board of directors of the company via a resolution passed by a majority vote of the directors present at a meeting of the board and attended by over two-thirds thereof;
- The shareholders of the company who have held at least 10% of the total issued and outstanding shares of the company for at least six consecutive months; or
- Creditors whose claims against the company are equivalent to 10% or more of the total amount of the company’s issued and outstanding shares.

Once the petition is received, the court will go through the following procedures before deciding whether to issue an order authorising the reorganisation (the “Reorganisation Order”):

- Refer the petition to “competent authorities” seeking their comments on the proposed reorganisation;
- Appoint an auditor to review the company’s business and financial status; and
- Ex officio or upon the petition of the company or interested parties, determine whether to issue an interim order (“Interim Order”) placing limitations on the company/creditors pending its decision on the Reorganisation Order.

The Interim Order cannot exceed a period of 90 days except in case of a reorganisation granted by the court. However, it can be extended for another 90 days upon petition by the company, the interested parties, or at the court’s own decision. By issuing the Interim Order, the court can order the following:

- Withhold/freeze the company’s property (from being disposed of, transferred or sold);
- Limit the company’s operations;
- Limit the company’s performance obligations and other assertion of claims against the company;
- Suspend the proceedings in relation to bankruptcy, composition or compulsory execution against the company;
- Prohibit the transfer of the registered share certificates of the company; and/or
- Investigate the company’s responsible persons for their liabilities for damage to the company and withhold/freeze their personal property.

Within 120 days of receiving the petition of reorganisation and upon referring to the reports and comments from the competent authorities and the auditor, if the court finds that all the statutory requirements were met and that the company is viable, the court will grant the Reorganisation Order. The 120-day period can be extended for another 30 days twice by the court. This effectively means that all bankruptcy proceedings, compulsory execution proceedings and other lawsuits will be automatically suspended.
Once the court issues the Reorganisation Order, it will serve a notice on the competent authority to register the reorganisation. The registration signals to the competent authority that the reorganisation process has begun, after which the court will also assist in:

- Appointing a reorganisation supervisor and manager;
- Giving public notice;
- Informing the creditors with regard to filing their claims;
- Arranging for the interested parties’ committee to be formed; and
- Preparing and approving the reorganisation plan.

In addition to the suspension of legal proceedings mentioned above, the Reorganisation Order effectively grants to a reorganisation manager operating under the supervision of a reorganisation supervisor the right to manage the company’s business and dispose of the company’s properties. This means the normal functions of a shareholders’ meeting, directors and supervisors are suspended.

The creditors will be notified of the dates and place for filing claims and the meeting of the interested parties. All creditors concerned must present all supporting documents and file their claims with the reorganisation manager/supervisor in accordance with the procedures prescribed by the court.

When the filing period expires, the reorganisation manager/supervisor will review the claims and consolidate a list of statutory priority creditors, secured creditors and unsecured creditors (the “List”). The List is then reviewed by the court, which will hold a hearing to review the filed claims before preparing a proposed reorganisation plan, which is forwarded to interested parties for their review and approval.

The creditors and other interested parties are entitled to:

- Attend the latter’s meeting;
- Review the business and financial condition of the company;
- Comment on the proposed reorganisation;
- Vote on the proposed reorganisation plan; and
- Decide other matters relating to the reorganisation.

The reorganisation plan details the claims that the reorganised company is to be assigned and has to be approved by the interested parties, which consist of shareholders, statutory priority creditors, secured creditors and unsecured creditors, at the meeting of interested parties. At the meeting of interested parties, the voting rights are exercised in groups of shareholders, statutory priority creditors, secured creditors and unsecured creditors, and resolutions shall be adopted by a majority vote of over one-half of the aggregate votes of each group. The number of votes of creditors in reorganisation shall be determined in proportion to the amounts of their claims, and the number of votes of shareholders shall be provided in the articles of incorporation of the company.

Once the reorganisation plan is approved, all debts will be extinguished except for those contained in the reorganisation plan. In addition, any bankruptcy, composition, compulsory
execution or other pending litigation involving company property prior to the Reorganisation Order will cease to have effect.

If the Reorganisation Order is not approved, any previous court order issued to withhold or freeze the company’s property, limit the assertion of claims or suspend legal proceedings will cease to have effect. Those creditors who have failed to file a claim will have their rights restored and the functions of the shareholders’ meeting, directors’ meeting and supervisors will resume.

Corporate Insolvencies

Court-Based Insolvencies

The mediation process is governed by articles 6 to 56 of the Taiwan Bankruptcy Law, which provide that the debtor may apply to the court or the local commercial association to settle the debts with its creditors through mediation. However, in practice, the outcome of the mediation is normally unsuccessful as the debtor lacks the assets to satisfy its creditors.

If a corporation is unable to repay its debts, or the court declares an end to the statutory reorganisation process of the corporation, the corporation is likely to face bankruptcy.

Bankruptcy Application

Bankruptcy may be initiated by either the debtor or a creditor when the debtor is unable to meet its debts as they are due. A debtor who has ceased to make repayments shall be presumed to be unable to pay its debts.

If the bankruptcy application is made by the debtor, the debtor must file with the court a report on the status of its assets and a list of creditors. If the application is made by a creditor, it must file a description of the debt owed. Upon receiving the bankruptcy application, the court will begin its investigation and seek the opinion of the debtors, creditors and other interested parties. Although the court is required to accept or reject the bankruptcy application within seven days of receiving it, it can take longer, and the seven-day period is not a statutory deadline.

When an application for bankruptcy is received, the court may, ex officio or upon application of the creditors, arrest or detain the debtor or give an order for precautionary measures, such as to freeze the debtor’s property from being disposed of, transferred or sold, before the bankruptcy is adjudicated.

After Bankruptcy is Adjudicated

Issuance of a Public Notice and Notification to the Creditors

Once the court adjudicates a debtor as bankrupt, it will appoint a trustee, typically a CPA, lawyer or creditor, to oversee and manage the sale and distribution of the bankrupt’s properties. Article 65 of the Taiwan Bankruptcy Law requires the court to issue a public notice informing creditors to report and file their claims with the trustee within a specified period. If the creditors fail to do so, they will not be entitled to repayments from the residual assets of the bankrupt. If the creditors are known to the debtor at the time of adjudication, individual notification must be sent to them informing them of the adjudication. The court will decide on a date for registering the claims. The date, however, must be between 15 days and three months after the adjudication of bankruptcy.

Other than issuing a notice and registering claims, the court is also required to decide on a date to hold the first creditors’ meeting to discuss the proposed timeline of the sale of assets.
and the order of distribution. The first creditors’ meeting must be held within one month after the adjudication of bankruptcy.

Trustee’s Right to Manage and Dispose of Properties

The bankrupt loses the right to manage and dispose of the properties that constitute the estate. The debtor must turn over books of accounts to the appointed trustee and respond to enquiries that may be raised by the trustee. The operation of the trustee is under close scrutiny by the court and, in practice, the trustee is expected to comply with any reporting duties, often appearing in court twice a week for big cases. The trustee’s decision to borrow money for the debtor or make compromises in lawsuits is subject to the consent of the supervisor.

The Bankrupt Estate

The bankrupt estate includes all properties owned by the debtor until the adjudication of bankruptcy and those acquired after the adjudication of bankruptcy, excluding certain items that are necessary for personal use and/or assets that are exempt from compulsory seizure under the ROC Compulsory Execution Laws. Exemptions from compulsory seizure include fuel, food and money, which are necessary for personal use, and sufficient cash to cover the debtor and his co-habitant relatives’ living expenses for two months.

According to article 78 of the Taiwan Bankruptcy Law, after the adjudication of bankruptcy, the trustee may request the court to avoid any gratuitous or other onerous transfers that are “prejudicial to creditors’ rights” completed prior to adjudication, if such transfers are voidable under the ROC Civil Code. Article 244 of the ROC Civil Code provides that any gratuitous transfer that prejudices a debtor’s creditors can be voided by the court and that any non-gratuitous transfers prejudicial to creditors and the debtor who is aware of the prejudice at the time of the transfer can be voided by the court. The claim for revocation in article 244 is extinguished by prescription if not exercised within one year from the moment when the creditor knew of the ground for revocation, or is extinguished after 10 years from the date of doing the act.

Under article 79 of the Taiwan Bankruptcy Law, the trustee may void any provision of security for an existing debt or repayment of any debt before it becomes due, if the provision of security or repayment occurs during the six-month period prior to the adjudication of the bankruptcy.

If the repayment is for any debt after it becomes due, under the interpretation of the Supreme Court judgments, such repayment will not constitute a voidable repayment under article 244 of the ROC Civil Code. The rationale behind this is that although the repayment of the outstanding debt will reduce the assets of a debtor, it also will reduce its liabilities and such repayment will not have any impact on the debtor’s financial ability.

Provable Claims under the Taiwan Bankruptcy Law

Article 98 of the Taiwan Bankruptcy Law states that the claims against the bankrupt established prior to the adjudication of bankruptcy shall be obligatory claims provable in bankruptcy (“provable claims”), unless the right of exclusion applies. The article requires a creditor to register provable claims with the trustee within a fixed period of time. A creditor has the right of exclusion when he has a pledge, mortgage or lien over the properties of the debtor before the adjudication of bankruptcy. Creditors who have the right of exclusion can exercise their rights without the need to comply with bankruptcy procedures.
Creditors who are also debtors of the bankrupt may set off the claims provided they arose prior to the adjudication of bankruptcy. The provable claims that have not yet become mature will be deemed to have matured upon the adjudication of the bankruptcy.

**Distribution of Bankrupt’s Estates**

After receiving registration of claims from the creditors, the trustee will prepare a plan of distribution that must be approved by the court and then published for the creditors or other interested parties to consider and raise any objections to. Objections must be raised within 15 days. If no objections are received, the trustee will proceed to divide and distribute the bankrupt’s estate among the creditors who do not enjoy the right of exclusion. The order of repayment is governed by article 112 of the Taiwan Bankruptcy Law, which states that claims subject to the right of priority in the properties of the bankrupt’s estates will be repaid before other creditors. Note that debts that have priority are normally payments required by law. If more than one claim enjoys the same level of priority, repayment will be made pro rata to the amounts of the claims.

**Close of the Bankruptcy Process**

When the court receives notice of the final distribution report from the trustee, it gives a ruling on the closure of the bankruptcy process. Upon the completion of the bankruptcy process, all debts of the bankrupt are discharged and the bankrupt is not liable for any further claims from the creditors unless the bankrupt has been convicted of fraudulent or mala fide bankruptcy.

**Out-of-Court Mechanisms**

Before filing the application for the reorganisation, certain creditors of an insolvent company may enter into a standstill agreement with the debtor for restructuring the debts, under which the creditors agree to refrain from taking legal action against the debtor for a specified period in exchange for the debtor agreeing not to prefer any creditors and usually to give security over all its unsecured assets and to control the expenditures of the debtor.

However, as the standstill agreement will not have a binding effect on a creditor who does not sign the agreement, such a creditor has no obligation to follow the standstill agreement. Therefore, once any creditor takes legal action against an insolvent company, it is unavoidable for other creditors under the standstill agreement to take legal action against the debtor.

**Conclusions and Additional Observations**

The out-of-court mechanism is seldom workable in Taiwan given that it is difficult to obtain a consensus from all creditors and there is no court order available for preserving the company’s property during the standstill period for avoiding any legal action against the debtor. As such, there is a trend towards court-supervised reorganisation for an insolvent company. Experience reveals that sufficient financial support and financial planning are key elements to the completion of any reorganisation proceedings. As such, recent court judgments on the reorganisation application focus on whether there is any real capital injection plan for an insolvent company. If there is no capital injection plan, the court tends to reject the reorganisation application on grounds that there is no possibility for the company to be reconstructed or rehabilitated through the proceedings.
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Overview and Introduction

Following the Asian economic crisis, Thailand made significant revisions to the Bankruptcy Act (1940) and assigned a Bankruptcy Court dedicated to bankruptcy and reorganisation cases. These changes were designed to facilitate the handling of insolvency and reorganisation and bring Thailand’s law closer to international concepts of bankruptcy practice. More recently, procedural reforms have been introduced to expedite bankruptcy proceedings and improve the efficiency and efficacy of official receivers and the courts. These reforms are ongoing. The Bankruptcy Act primarily covers two areas of bankruptcy law: insolvency and reorganisation.

Applicable Legislation

The applicable legislation includes the Bankruptcy Act B.E. 2483 (1940) and the Act Establishing Bankruptcy Courts and Bankruptcy Case Procedures B.E. 2542 (1999).

Personal Bankruptcy

Personal bankruptcy in the Thai system can only be commenced by a creditors’ petition being filed with the Bankruptcy Court. There is no provision allowing voluntary bankruptcy under Thai law. If the petitioning creditor can verify the debtor’s state of insolvency, and there are no reasons why the debtor should not be adjudged bankrupt, the court will issue an absolute receivership order. This order triggers the Official Receiver to locate and collect the debtor’s assets, and remove the debtor’s control of its assets.

Although there is no firm definition of “insolvent” under Thai bankruptcy law, Supreme Court decisions take “insolvent” to mean persons whose assets are less than their debts. As it can be rather difficult for a creditor to prove that the debtor’s total assets are less than its total debts, the Bankruptcy Act provides certain presumptions of insolvency, such as a failure of the debtor to make repayment after receiving two notices with an interval period of 30 days. Once the creditor establishes one of the presumptions under the Bankruptcy Act, it shall be presumed that the debtor is insolvent. Then, the debtor will have the burden of proof to rebut such presumption.

One special feature under Thai law is the ability of a creditor to seek a temporary receivership order, through an ex parte injunction, in order to freeze the debtor’s assets or require the debtor to provide security. This special pre-bankruptcy action is designed to prevent a debtor from liquidating its assets to the detriment of its creditors. After receiving the bankruptcy petition, the court will set a first hearing date at which objections to the bankruptcy petition will be considered. Following the hearing, and the examination of the bankruptcy petition and the acceptance of the petition by the court, the court will issue an absolute receivership order and the Official Receiver will seize and control all of the debtor’s assets.

Prior to the first meeting of creditors, the debtor may propose a composition of debts to the Official Receiver, by which the debtor may propose the composition of debts or the method of management of business and assets and details of security. Subject to the composition meeting certain minimum requirements, creditors may agree to accept the proposal by special resolution of a meeting of creditors, requiring the approval of creditors representing 75% of the debt with a majority of the creditors attending the meeting. If the approval of a composition fails, the debtor will be declared bankrupt and the seizure and liquidation of the debtor’s assets will be carried out by the Official Receiver and distributed according to the creditors’ preferential ranking.
The debtor can be released from bankruptcy by a post-bankruptcy composition of debts and discharged from bankruptcy under the Bankruptcy Act and termination of bankruptcy on four grounds:

- that no creditor assists the Official Receiver in the collection of assets;
- the debtor should not be adjudged bankrupt;
- the debts of the bankrupt have been paid in full; and
- during the 10-year period after the closure of the bankruptcy action, the Official Receiver has been unable to collect any further assets of the bankrupt.

An individual debtor is automatically released from bankruptcy three years from the date the court adjudged the debtor bankrupt, unless there are special grounds based on the debtor’s dishonest actions.

Corporate Insolvency and Restructuring

There are three types of procedure available for corporate debtors.

First, a creditor-initiated bankruptcy, whereby the successful verification of the debtor’s insolvency by the creditor leads to a court order of absolute receivership and the process is under judicial supervision.

Second, a debtor-initiated bankruptcy through voluntary liquidation as a result of a special resolution of shareholders, whereby liquidators of a registered partnership, limited partnership or limited company may, if its contributions or shares are fully paid up and where its assets are insufficient to meet its liabilities, apply with the court to have the entity declared bankrupt.

The issues regarding the meaning and establishment of insolvency noted in the section on “Personal Bankruptcy” are also applicable to corporate bankruptcy. Moreover, in the case of entities, Thai courts tend to rely heavily on the balance sheet of the company. As such, in cases where the debtor attempts to inflate its assets to create a positive balance sheet, creditors will require strong proof to convince the court that the debtor is insolvent.

Also applicable to corporate bankruptcy are the ability to seek a temporary receivership order, the ability of the corporate debtor to propose a composition of debt and the methods of release from bankruptcy. However, the automatic release from bankruptcy that is applicable in a personal bankruptcy, as mentioned above, is not applicable to a corporate bankruptcy.

As with personal bankruptcy, after receiving the bankruptcy petition, the court will set a first hearing date, at which objections to the bankruptcy petition will be considered. Following a hearing and its acceptance by the court, an absolute receivership order is issued and the Official Receiver will seize and control all of the debtor’s assets.

The third type of procedure for corporate debtors is a business reorganisation procedure, either creditor- or debtor-initiated, with the objective of rehabilitating the business. A reorganisation planner (the “Planner”) or plan administrator (the “Administrator”) operates this procedure with judicial oversight.

A petition for business reorganisation may be submitted by the debtor, its creditor or relevant government authorities. Upon submission of the petition, and the court granting an order
accepting the petition, an automatic stay will come into effect and parties will be prohibited from taking certain actions regarding the debtor, such as:

- commencing litigation or requesting that the court wind up the debtor;
- revoking the licences of the debtor to undertake various activities or ordering the debtor to cease such activities;
- commencing a civil case or arbitration regarding the debtor’s assets with regard to debts incurred prior to the date that the court issues an order to approve the plan;
- commencing a bankruptcy action against the debtor;
- enforcing a judgment against the debtor’s assets for debts incurred prior to the date that the court issues an order to approve the plan;
- enforcing security without court approval; or
- transferring, disposing of, leasing out or incurring debts, or undertaking any action that creates a burden over property unless this is necessary for normal trade activities.

As with a typical bankruptcy proceeding, the court will set an enquiry hearing at which objections to the petition will be considered. Following the court’s order to reorganise the debtor’s business, all powers to manage the debtor’s company will pass to the Planner and then to the Administrator after the court approves the reorganisation plan. Unless the debtor acts as its own Planner or Administrator, the Planner and Administrator must be registered with the relevant authority. In the latter case, the party acting as the Planner or Administrator must place a deposit with the Business Reorganisation Office to guarantee that their performance does not damage the debtor or the creditors. After the Planner appointment order is published in the Government Gazette, creditors have one month to lodge their provisional creditor claims with the Official Receiver, failing which, creditor claims will be barred.

The plan must be approved by special resolution (75% of the debts in each group) of the creditors’ meeting of every group of the creditors, or at least one group of creditors with the total debt of all creditor groups at the meeting tallying to not less than 50%. In this regard, the majority creditors can impose a plan on minority creditors, including a plan with a debt haircut. Under Thai law, any debt that is forgiven under a reorganisation plan is exempt from taxation.

Subsequently, the court must approve or reject the plan. In this regard, the court is required to examine any objections to the plan. In the event the plan is rejected, the court may simply revoke the order granting permission to reorganise and return the debtor to a state of normal business operation or, if there is a pending bankruptcy lawsuit against the debtor, the court will order to continue that bankruptcy lawsuit.

The Administrator must be named in the plan and approved at the creditors’ meeting. After the plan is approved, the Administrator has a period of five years to successfully implement it. This period may be extended twice for additional one-year terms. In addition, the court may further extend the period of the business reorganisation, at its sole discretion, if it appears to the court that the reorganisation is close to successful completion. The Administrator has a duty to make a periodical report to the Official Receiver, who is a government official under the Ministry of Justice, and to the court. At the request of the committee of creditors appointed by the creditors’ meeting, the debtor’s executive, or the
Official Receiver, the court has the power to remove the Administrator if there is any wrongdoing or if the Administrator is deemed to be incompetent.

Special Powers to Cancel Fraudulent Acts, Acts of Undue Preference and Executory Contracts

An important feature of both the bankruptcy and reorganisation laws is the ability to have fraudulent acts, acts of undue preference, and executory contracts invalidated during the bankruptcy or reorganisation process.

The Planner, Administrator or Official Receiver may ask the court to cancel a fraudulent act by filing a motion with the court. A fraudulent act is defined as an act conducted by the debtor with the knowledge that such act would prejudice its creditor. However, this nullification does not apply if the third party who received the benefit from such an act gave fair value for the act and did not know, at the time of the act, that such an act would prejudice creditors. The prescription period to request nullification is within one year from the time the creditor knew of the cause for nullification of the act or within 10 years from the occurrence of the act. If the alleged fraudulent act was conducted within one year before the filing of the application for bankruptcy or reorganisation, it shall be presumed that the debtor and the third party had knowledge that it would prejudice creditors.

When it appears there has been a transfer of assets or any other act that the debtor has committed or allowed to be committed within the period of three months before the filing of the petition and thereafter, with the intent to place any creditor in an advantageous position over the other creditors, the Planner, Administrator or Official Receiver may file an application with the court requesting nullification of such transfer or such act.

In addition, within the time period of two months from the date the Administrator is informed of the court’s approval of the reorganisation plan, the Administrator has the right to refuse to accept rights under a contract whereby the obligations exceed the benefits to be received, provided that such rights were included as part of the reorganisation plan approved by the creditors’ meeting and the court.

Therefore, when entering into an agreement with, or receiving any assets from, a debtor who is insolvent (e.g. receiving repayment for a loan, receiving a letter confirming a debt or damages), a party should take into consideration the risk that the transaction may be nullified as a fraudulent act or as displaying undue preference. It should be noted that, for undue preference, even if the creditor who receives the assets or repayment is acting in good faith, the act is still subject to nullification. The law focuses only on whether or not such an act gives preference to one creditor over other creditors, which also means that the creditor who receives the assets or repayment must be the existing creditor at the time the act is committed and that the debtor is in an insolvent status at the time the act is committed.

Appellate Procedure

At present, appeals against orders of the Bankruptcy Court or the Official Receiver, in both bankruptcy and reorganisation cases, are made directly to the Supreme Court and are limited to certain circumstances, such as an appeal against an order dismissing the petition, an appeal against an order on a creditor claim, or the rendering of an absolute receivership order. However, legislation has been announced to establish a specialist division of the Court of Appeal which, once it has been established, will have jurisdiction over such appeals.
Small and Medium Enterprises

On 25 May 2016, legislation implementing a streamlined reorganisation process for small and medium enterprises (‘SMEs’) came into force. The regime applies to individuals, juristic bodies, ordinary partnerships (registered and unregistered), limited partnerships, and limited companies, provided they are registered with the Office of SME Promotion.

Eligibility for reorganisation is subject to the entity or person proving illiquidity as a result of debts from their business operations. Those debts must total at least THB 2 million for individuals, and THB 3 million for juristic persons. For limited companies who qualify as SMEs, the debts must not exceed THB 10 million, or the standard reorganisation procedure will apply.

Under the SME regime, the petitioner is required to file a reorganisation plan, supported by creditors holding a total of two-thirds of the overall debt, at the same time as it files a business reorganisation petition. The court can therefore approve both at the same time, allowing the SME to implement the plan much more quickly than under the standard reorganisation procedure.

Out-of-Court Mechanisms

The Thai Bankruptcy Act does not include provisions for workout mechanisms or pre-court options such as settlement of debt.

Criminal Penalties

It is also noteworthy that Thai bankruptcy law provides specific criminal penalties for the bankruptcy and reorganisation processes, and the Bankruptcy Court is empowered to administer these penalties.

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Ukraine

Overview

This Guide summarises the impact of the main provisions of the law relating to bankruptcy in Ukraine and the manner in which it affects the claims of those involved in the insolvency or restructuring of a Ukrainian debtor.

Legislation

Ukraine’s first Law On Bankruptcy entered into force on 1 July 1992. On 30 June 1999, the law was significantly amended and restated, and now exists as the Law On Re-establishing Solvency of Debtors or Recognition of Debtors’ Bankruptcy (the “Bankruptcy Law”). On 19 January 2013, a new edition of the Bankruptcy Law came into force, which significantly amended the rules of bankruptcy proceedings and their conduct in Ukraine.

Debtors Exempt from Bankruptcy

The Bankruptcy Law and certain other Ukrainian legislation establish a number of fundamental principles that must be borne in mind when making deals with potential Ukrainian debtors.

Under the applicable Ukrainian legislation, the following debtors have absolute or limited immunity from the judicial bankruptcy procedures:

- state enterprises included in the list approved by the Law of Ukraine On List of State Owned Objects Which Cannot Be Privatized;
- state enterprises that fall under the category of “kazenne pidpryyemstvo”;
- mining companies with a market share of at least 25% owned by the state, which have been privatized within one year from the commencement of the relevant privatisation plan, with the exception of companies liquidated through the decision of their owners; and
- public joint-stock companies in the business of providing railway transport for general use established under the Law On Specifics of Establishment of Public Joint-Stock Companies of Railway Transport for General Use.

Pre-Trial Rehabilitation of Debtors

A debtor or a creditor is entitled to initiate the debtor’s financial rehabilitation procedure prior to the commencement of the debtor’s declaration of bankruptcy in court. The procedure of the debtor’s rehabilitation can be envisaged in an agreement between the debtor and the creditor. A pre-trial rehabilitation may be commenced upon the following conditions:

- obtaining the written consent of the debtor’s supervising authority;
- obtaining the written consent of the creditors whose aggregate amount of claims exceeds 50% of the debtor’s debts according to the debtor’s financial statements; and
- obtaining approval for the solvency rehabilitation plan by all secured creditors and the General Creditors’ meeting.
The General Creditors' Meeting is called when a written notice is sent to the creditors, in accordance with the debtor's accounting information.

The debtor or a representative of the creditors shall file with the court, at the location of the debtor, an application for the approval of the debtor's rehabilitation plan within five calendar days from the date of its approval by the creditors.

Upon the court’s approval of the debtor's rehabilitation plan, the court will impose a moratorium prohibiting the satisfaction of the creditors' claims during the debtor's rehabilitation. The moratorium cannot last longer than 12 months. During the pre-trial rehabilitation of the debtor, the debtor's declaration of bankruptcy cannot be commenced in court.

Specifics of Bankruptcy Proceedings for Certain Categories of Debtors

Bankruptcy proceedings for certain categories of debtors have important specific features, compared with the generally applicable bankruptcy regime. Such categories of debtors include companies of special social importance or companies having special status, banks, insurance companies, securities traders and joint investment institutions, issuers or managing companies of mortgage certificates, managers of utility (construction financing) funds, managers of real property operation funds, enterprises at least 50% of whose charter capital is owned by the state, agricultural producers, farms, private (individual) entrepreneurs, and debtors liquidated by their owners. Specific features of the bankruptcy proceedings for such enterprises include unique terms and conditions of the bankruptcy proceedings, obligatory participation of competent state authorities in bankruptcy proceedings, provision of guarantees, a special list of priorities for the satisfaction of creditors' claims, extension of the term of the bankruptcy hearings, special sale procedures, and restrictions on the attachment of the debtor's assets.

Initiation of Bankruptcy Proceedings

A bankruptcy petition may be brought to a Ukrainian commercial court (“hospodarsky sud”) at the location of the debtor by any creditor (other than a fully secured creditor), the debtor itself, the State Tax Administration and certain other state agencies acting as the creditors. A creditor (an individual or a business entity) that holds an incontestable claim against the debtor may initiate the bankruptcy proceedings against the debtor, if the amount of the claim is not less than 300 minimum monthly salaries and the claim remains unsatisfied by the debtor three months after the expiration of the established term for its initial satisfaction. From January 2016 to April 2016, the minimum monthly salary in Ukraine was UAH 1,378; starting from May 2016 and until December 2016 the minimum monthly salary is UAH 1,450; and starting from 1 December 2013, UAH 1,550. Where the claim is denominated in a foreign currency (e.g. US dollars, euros, etc.), the creditor must apply the official exchange rate established by the National Bank of Ukraine (http://www.bank.gov.ua/control/en/index) as of the day of filing of the application for the commencement of the bankruptcy proceedings with the competent court, in order to determine the amount of the claim in Ukrainian hryvnyas and to prove that it meets the minimum amount requirement established by the Bankruptcy Law for the commencement of the bankruptcy proceedings.

In principle, there are two ways in which a creditor may participate in bankruptcy proceedings: a creditor may either bring the bankruptcy petition itself or, if another party has already initiated the bankruptcy proceedings, it may join the proceedings by way of filing of a participation petition.

Once the bankruptcy proceedings have been triggered, any creditor (except a fully secured creditor) may, within 30 days of the formal publication of the commencement of the
bankruptcy proceedings against the debtor on the official site of the Supreme Commercial Court of Ukraine (http://vgsu.arbitr.gov.ua/pages/157), submit a participation petition substantiating its claims against the debtor. Creditors whose claims have matured prior to the commencement of the bankruptcy proceedings and were submitted after the expiration of the aforesaid 30-day period will not have the right to participate and to vote in the creditors’ committee (the “committee”), and their claims will be satisfied in the sixth (i.e. the last) order of priority.

A creditor whose claims were fully secured by collateral is deemed to be a secured creditor and, as a matter of law, such creditor may not initiate bankruptcy proceedings. If a secured creditor considers its claims as not fully secured, or if the collateral has been lost or is missing, the creditor can initiate the bankruptcy proceedings or participate as a creditor with respect to the unsecured part of its claims or all its claims.

Stages of Bankruptcy Proceedings

The judicial bankruptcy proceedings in Ukraine may include the following stages:

• special proceedings for the disposal of the debtor’s assets (the assets administration proceedings);
• solvency renewal proceedings;
• amicable settlement; and
• liquidation proceedings.

Assets Administration Proceedings

Under the assets administration proceedings, the Ukrainian commercial court appoints a bankruptcy administrator (“rozporyadnyk mayna”) who will supervise and approve the disposal of the debtor’s assets. The court may impose a moratorium on the discharge of the claims of the debtor’s creditors that arose before the date of the initiation of the bankruptcy proceedings.

A bankruptcy administrator is an individual who is registered as a private entrepreneur and licensed to act as the administrator of the debtor’s assets, the solvency renewal administrator or the liquidator at each respective stage of the bankruptcy proceedings.

In the assets administration proceedings, the bankruptcy administrator: (i) identifies the creditors; (ii) prepares the register of the creditors and the amounts claimed from the debtor for further approval by the court; and (iii) organises the general meeting of the debtor’s creditors, which in turn appoints the committee.

Once elected, the committee is entitled to: (i) initiate the solvency renewal proceedings or the liquidation proceedings against the debtor; (ii) agree on the terms and conditions of the solvency renewal plan and apply to the court for its approval; (iii) provide the court with candidates for the appointment of the solvency renewal administrator and the liquidator, as well as to apply for their replacement; (iv) agree on the terms and conditions of the amicable agreement and apply to the court for its approval; and (v) decide on other practical issues of the bankruptcy proceedings.

The creditors participating in the general meeting of the creditors or in the meetings of the committee are allocated a number of votes determined pro rata on their respective claims, and they make their decisions by the majority of the votes.
Assets administration proceedings may last 115 calendar days and may be further extended by the court for two months upon a request by the bankruptcy administrator, the committee or the debtor.

Solvency Renewal Proceedings

Solvency renewal proceedings may be introduced by the court as the next stage of the bankruptcy proceedings. This may last for six months, and may be extended for another 12 months upon a request by the committee or the solvency renewal administrator.

Upon the ruling on the introduction of the solvency renewal proceedings, the court appoints the solvency renewal administrator, who acts as the head of the debtor. For the period of the solvency renewal proceedings, other managing bodies of the debtor will not be able to exercise their statutory powers.

The solvency renewal administrator must submit the solvency renewal plan to the court for approval within three months from the day of the court ruling on the appointment of the solvency renewal administrator. If the debtor is a state-owned company in which the state owns not less than 50%, the solvency renewal plan is subject to approval by the state authority supervising the disposal of the property.

The solvency renewal plan may include the corporate restructuring of the debtor, the sale of its assets, the recovery of receivables, debt restructuring, restructuring of assets, the sale or cancellation of the debt, and other means of renewal of the debtor’s solvency. The solvency renewal plan may also provide for the replacement of assets, a procedure according to which a part of the debtor’s assets and obligations can be alienated to a newly established entity created by the debtor. The shares of such newly created entities can be included in the debtor’s assets and sold through auction.

Liquidation Proceedings

If the solvency renewal administrator fails to provide the solvency renewal plan to the court for approval within six months from the day the solvency renewal proceedings commence, the court may recognise the debtor as bankrupt and commence the liquidation proceedings (i.e. the final stage of the bankruptcy proceedings).

The court may also introduce the liquidation proceedings with the relevant ruling, if the debtor has failed to restore its solvency in accordance with the solvency renewal plan, upon the request of the committee.

It should be noted that the committee may ask the court to commence the liquidation proceedings after the assets administration proceedings, omitting the solvency renewal proceedings. Upon the introduction of the liquidation proceedings, the court will appoint the liquidator, who will act as the head of the debtor. For the period of the liquidation proceedings, other managing bodies of the debtor will not be able to exercise their statutory powers.

In liquidation proceedings, the liquidator must determine the liquidation value of the debtor’s assets, sell these assets and pay off the debt to the creditors in accordance with the priority order of the satisfaction of the creditors’ claims as established by the law.

Upon the completion of the liquidation proceedings, the liquidator will prepare the report, as well as the liquidation balance sheet of the debtor, and provide them to the court for consideration and approval. Based on the results of the liquidation proceedings, the court may approve the report and the liquidation balance sheet of the debtor, dissolve the debtor and terminate the bankruptcy proceedings.
According to the Bankruptcy Law, liquidation proceedings may take 12 months from the day of commencement.

Amicable Agreement

At any stage of the bankruptcy proceedings, the creditors and the debtor may enter into an amicable agreement with a view to restructuring and/or cancellation of the debt. However, the first priority debt cannot be cancelled or restructured, and the debt arising from mandatory pension and social security contributions cannot be cancelled by the amicable agreement.

The parties to the amicable agreement may agree on the transfer of the debt to third parties or the transfer of the debtor’s assets or corporate rights to its creditors in exchange for the cancellation of the debt.

The amicable agreement is subject to the approval of the committee, all secured creditors and the court, and becomes effective on the day the court approves the amicable agreement. Upon the approval of the amicable agreement, the court terminates the bankruptcy proceedings.

It should be noted that the amicable agreement may be invalidated by the court on the legal grounds provided by the Civil Law of Ukraine. When the amicable agreement is invalidated, the court may reinstate the bankruptcy proceedings against the debtor.

The creditors may apply to the court for the termination of the amicable agreement in the event of non-performance of the agreement by the debtor with regard to not less than one-third of the total amount of the debt. The termination of the amicable agreement for a specific creditor or creditors will not terminate the agreement for the rest of the creditors.

Priority of Claims

Amounts received from the sale of the bankrupt’s assets are used to pay the claims of its creditors in the following order:

First priority:

- The payment of termination allowances to the bankrupt’s employees, and repayment of any loan received by the bankrupt for the purpose of the payment of such termination allowances.
- Claims of the creditors under insurance agreements.
- Claims for recovery of costs associated with the conduct of the bankruptcy proceedings.

Second priority:

- Liabilities arising from the infliction of harm to life or health of an individual, by means of capitalization of the respective payments, *inter alia*, to the Employment Injuries and Occupational Diseases Insurance Social Fund regarding the employees insured in this fund.
- Liabilities relating to mandatory pension and social security contributions.
- Claims of individuals whose property or funds are deposited with the bankrupt (where the bankrupt is a trust company or “dovirche tovarystvo”, a bank or other credit-
financial institution, or any other business entity attracting the assets of individual depositors).

Third priority:
• Local and state taxes and other mandatory payments.
• Claims of the State Reserve Fund.

Fourth priority:
• Claims of creditors not secured by a pledge (mortgage) of the bankrupt’s assets (other than the claims of the fifth priority and the sixth priority), including claims that have arisen during the assets administration proceedings or the solvency renewal proceedings.

Fifth priority:
• Claims for the “repayment of the bankrupt’s employees’ contributions to the charter fund” of the bankrupt.
• Claims for the payment of additional remuneration to the solvency renewal administrator or the liquidator.

Sixth Priority:
• Other remaining claims.

Higher priority claims must be satisfied in full before any lower ranking claims may be paid. In the event that the cash proceeds from the sale of the property are insufficient to satisfy all claims with equal priority, they must be satisfied pro rata. Claims not paid due to the insufficiency of funds in the liquidation proceedings are deemed extinguished. Any assets remaining after the satisfaction of the claims of the creditors are to be returned to the “owners” of the debtor (i.e. its shareholders or holders of its participatory interests) if the court decides to dissolve the debtor. The court will not be able to dissolve the debtor if the remaining assets of the debtor exceed the amount of assets that is required by the law for the operation of a relevant legal entity.

Note that Ukrainian legislation establishes a special order of priority of satisfaction of creditors’ claims for certain categories of debtors (including banks).

Clawback
A transaction entered into by a Ukrainian debtor after the commencement of the bankruptcy or within one year before the commencement may be challenged by the bankruptcy administrator or by the creditors within the bankruptcy proceedings, if:
• the debtor alienated its assets, assumed obligations or surrendered its claims without compensation;
• the debtor has fulfilled its obligations before the due date;
• prior to commencement of the bankruptcy proceedings, the debtor entered into the agreement that led to its insolvency;
• the debtor paid to its creditor or accepted any property/assets as a set-off of payment obligations of its contractor when the debtor’s assets became insufficient to satisfy the creditors’ claims;

• the debtor alienated or acquired property at a price that was lower or higher, respectively, than the market price, provided that the debtor’s assets were insufficient for the satisfaction of the creditors’ claims at that time; or

• the debtor pledged its property to secure the fulfilment of pecuniary claims.

Criminal Liability

Under the Criminal Code of Ukraine, “letting bankruptcy” is defined as the intentional activity, with mercantile or personal motives or in the interest of third parties, of an individual shareholder (participant) or a corporate official of an enterprise, that has caused the sustainable financial incapability of such enterprise and substantial material damages (i.e. for 2016 – starting from 1 May an amount exceeding UAH 344,500) to the state or a creditor. This crime is punishable with a monetary penalty of 2,000 to 3,000 monthly standard non-taxable incomes of individuals as determined yearly by the law (i.e. from UAH 34,000 to UAH 51,000), and the perpetrator is prohibited from occupying certain positions and conducting certain activities for a period of up to three years.

The Criminal Code of Ukraine, as amended on 16 July 2015, provides for criminal liability for the falsification of information regarding contracts, obligations or property which is provided by a financial institution in its records or accounting documents and for the disclosure of such information if the falsification was aimed at concealing bankruptcy or persistent financial insolvency. The Criminal Code of Ukraine provides for punishment for such actions in the form of a monetary penalty of 800 to 1,000 times the monthly non-taxable salary (i.e. from UAH 13,600 to UAH 17,000) or imprisonment for up to four years with a prohibition against occupying certain positions or conducting certain activities for a period of up to 10 years.

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Overview

The starting point for advising on issues relating to insolvency in the UAE is to identify the insolvency laws that will apply to the borrower in question. That may in turn depend on where the borrower is located because there are within the UAE a number of designated free zones, certain of which have been exempted from the federal laws of the UAE relating to civil and commercial matters and have developed their own insolvency laws and regulations. The Dubai International Financial Centre is one such free zone which falls within this category (see “Free Zones” below).

Outside of the free zones the federal insolvency laws of the UAE will generally apply. This Guide is concerned primarily with a discussion of those laws. The federal laws provide for bankruptcy, rescue and liquidation procedures. The laws are, to our knowledge, relatively untested: they are inconsistent in certain respects and do not deal with all contingencies. Accordingly, there is a degree of uncertainty as to how the laws would be applied by the local courts in practice. Also, there are a number of provisions which in our view are likely to be of particular concern to creditors. For example, as noted below, following a petition by creditors for a bankruptcy order, the court may postpone making a decision with respect to the company’s bankruptcy for a period of up to one year where the company’s financial position is likely to be supported or if it is in the interests of the national economy for the decision to be postponed.

The above issues, allied with the fact that creditor groups tend to be diverse (often including international banks, local banks, Islamic funders, sukuk holders and trade creditors) and (perhaps) share a cultural preference for privacy in such matters, have militated, so far, against the use of legislative insolvency and restructuring procedures. Informal work-outs have instead been favoured. In the case of major insolvencies, specific state intervention is also possible.

Applicable Legislation

The federal laws of the UAE governing bankruptcy, restructuring and insolvency are set out (primarily) in Federal Law No. 18 of 1993 (the “Commercial Code”) and then in Federal Law No.2 of 2015 (the “Companies Law”). Certain provisions of Federal Law No. 5 of 1985 (the “Civil Code”), Federal Law No. 3 of 1987 (the “Penal Code”) and Federal Law No. 11 of 1992 (the “Civil Procedures Law”) also apply in relation to bankruptcy. Certain provisions of Federal Law No. 10 of 1980 apply to the liquidation of a bank or financial institution. The new insolvency law is currently in draft form and expected to regulate bankruptcy and liquidation matters in more detail. However, in the absence of the final version of this law, we cannot advise on the definitive position relating to new bankruptcy and insolvency regulation in the UAE.

Liquidation

The Companies Law regulates the dissolution and liquidation of companies. Under UAE law, dissolution is a termination procedure. Liquidation is a radiation procedure for the realisation of a company’s assets and, to the extent possible, the payment of its debts.

A company may be dissolved on any of the following grounds:

- a depletion of the company’s assets rendering the investment of the company’s remaining assets for benefit impossible;
the expiry of the term of the company as specified in its constitutional documents;

the fulfilment of the objects of the company as set out in its memorandum of association;

the amalgamation of the company with another company; and

a decision of the company’s shareholders in accordance with its memorandum of association.

If the losses of a joint stock company amount to half of its share capital or more, the company’s board of directors must call a general assembly of the company’s shareholders to decide, by special resolution, whether the company should be dissolved. If the board fails to call a general assembly, or if the general assembly is unable to adopt a decision, any interested party may initiate proceedings for the dissolution of the company.

Similarly, if the losses of a limited liability company (the company form most commonly adopted in the UAE in connection with a foreign investment) amount to half of its share capital or more, the managers (directors) must call a general assembly of the partners (shareholders) to decide whether the company should be dissolved. The number of votes required to pass the resolution is the same as the majority specified in the company’s constitutional documents for the variation of the company’s memorandum. If the losses of the limited liability company equal or exceed three-quarters of its share capital, shareholders holding 25% or more of the company’s share capital may initiate the company’s dissolution.

The dissolution of a company must be publicly declared by registering it in the Commercial Register and publishing it in two local daily Arabic newspapers. The company will thereafter be considered to be in liquidation and the expression “Under liquidation” must be added to the company’s name.

A liquidator is appointed by the company’s shareholders acting in general assembly, or where liquidation occurs as a result of a court order by the court. The liquidation will occur in accordance with the Companies Law, although a company’s memorandum or articles may specify how the company’s liquidation should proceed, or the shareholders may themselves agree on a process for the liquidation of the company’s assets.

Once the liquidator is appointed, the powers of the company’s board vest in the liquidator. Those powers include the ability to commence or defend legal claims and to take steps necessary for the protection and preservation of the company’s assets. The liquidator must complete its duties within the time specified in the document under which the appointment is made or within the time specified by the court.

The liquidator must, following its appointment, ascertain the company’s assets and liabilities. The liquidator is also required to collect amounts owed to the company and realise the company’s assets for the benefit of the company’s creditors. The liquidator will write to known creditors calling for them to submit their claims, and for unknown creditors the notice may be made by publication in two local daily Arabic newspapers. Creditors must submit their claims within 45 days of notice of liquidation being given. If a creditor fails to present a claim or a debt is disputed, the liquidator is required to set aside an amount pending the resolution of the claim or dispute.

If the proceeds of the realisation of the company’s assets are insufficient to pay the company’s creditors in full, the liquidator pays those creditors ratably according to their claims without prejudice to the rights of priority creditors. The ranking of creditors in a liquidation and bankruptcy is discussed below.
Any proceeds remaining after the payment of creditors will be distributed among the company’s shareholders ratably according to their shareholding in the company. Upon the completion of the liquidation process, the liquidator must submit a final account to the shareholders in general assembly, and upon ratification of that final account the liquidation will cease and the liquidation will be noted on the Commercial Register. The company will then be struck off the Commercial Register.

Bankruptcy

Bankruptcy is an insolvency procedure which may apply to a “trader”. Under UAE law, a trader includes:

- an individual engaged in commercial activities in his own name and for his own account; and
- every company which undertakes a commercial activity or has adopted one of the forms available under the Companies Law.

The forms of corporate personality available under the Companies Law include:

- joint liability companies;
- limited partnerships;
- public joint stock companies;
- private joint stock companies; and
- limited liability companies.

Circumstances in which a Trader may be Declared Bankrupt

Any trader who has suspended payment of its commercial debts due to its financial position or poor credit may be declared bankrupt. A trader which adopts abnormal or illegal commercial practices indicating poor financial condition shall be deemed to have suspended payment.

Bankruptcy is declared by a court judgment. It may be declared at the initiative of a trader or following a petition by its creditors. A trader must petition for bankruptcy within 30 days of suspending the payment of its commercial debts. If the trader does not do so, the trader (directors) may be guilty of the criminal offence of bankruptcy by negligence. A creditor may petition for bankruptcy in respect of a debt which has become due, or in respect of moneys owing which are not yet due or which are contingently owing where the trader has fled the UAE. However, in each case the creditor must establish that the trader has suspended payment of its commercial debt, i.e. it appears that non-payment of the creditor itself may not be enough, although (depending on the unpaid amount in question) that may go some way towards evidencing a suspension of payment by the trader.

A court may, either of its own accord or as requested by the company, postpone making a decision with respect to the trader company’s bankruptcy for a period of up to one year, if the company’s financial position is likely to be supported or if it is in the interests of the national economy for the decision to be postponed. If such an order is made, the court is required to make orders necessary to ensure that the assets of the company are maintained during the intervening period.
Bankruptcy Procedure

The court may, following a petition for the bankruptcy of a trader, make orders necessary to protect the assets of the trader. The court may appoint an expert to determine the trader’s financial position and to investigate whether the trader has suspended the payment of its debts and, if so, the reasons for such suspension.

If the court is satisfied that the trader should be declared bankrupt, the court passes an order of adjudication declaring the trader bankrupt and appoints a trustee in bankruptcy to administer the bankruptcy.

The court fixes a provisional date for the date on which the company stopped paying its debt, which cannot go back for more than two years from the date of the insolvency judgment and orders that the company’s place of business be sealed. A copy of the bankruptcy order will be made available to the Ministry of Economy, the relevant Commercial Register and the UAE Central Bank. The trustee in bankruptcy must within 15 days thereof publish a summary of the bankruptcy adjudication in a daily newspaper specified by the court. The publication must invite the company’s creditors to have their debts recorded in the bankruptcy. The court may thereafter of its own accord, or at the request of the trustee in bankruptcy, the company’s creditors or other interested persons, amend the date for the company to cease paying its debts, provided that such date is no later than 10 days after the company’s debts are verified. Such an order must also be published in a daily newspaper as specified by the court.

The trustee in bankruptcy must do all that is necessary to realise the bankrupt trader’s assets, including pursuing claims against third parties on behalf of the trader.

Following the publication of the adjudication of bankruptcy in the local newspaper each of the trader’s creditors must submit a statement setting out its claims against the bankrupt trader. If such documents are not received within 10 days, the trustee in bankruptcy should publish a further notice in a local newspaper specified by the judge in bankruptcy and should serve notice on known creditors. Creditors then have 10 days to submit claims (30 days for non-residents). The trustee in bankruptcy may notify a creditor that it objects to any part of a claim or any collateral claimed to be held by the creditor. The creditor then has 10 days (30 days for non-residents) to provide evidence in support of its claim(s).

The trustee in bankruptcy must then deposit with the court a document setting forth the company’s creditors and their claims (including claims which it is objecting to and the basis for the dispute) and the securities held against those claims. Dissenting creditors have 10 days (30 days for non-residents) to bring an objection before the court. The court then prepares a document setting forth the claims of creditors which have been accepted, and the court rules on objections.

Creditors who fail to submit claims within the above prescribed periods risk forfeiting their rights or, to the extent they are permitted to lodge claims following the time period(s) for doing so, having those claims postponed to creditors sharing in earlier distributions.

Position of the Trader

Upon the declaration of bankruptcy the bankrupt trader may no longer operate its business. The bankrupt trader may not itself pay any debts or recover any amount owing to it. It would be the trustee in bankruptcy who may act in such circumstances.
Moratorium on Claims

Save for holders of mortgages and certain liens, or with the special leave of the court, creditors are prohibited from pursuing remedies against the trader’s estate after bankruptcy is declared. However, if there are insufficient funds in the trader’s estate to meet the expenses of the trustee in bankruptcy, the bankruptcy may be terminated and in such circumstances creditors regain the right to proceed individually against the bankrupt trader.

Set-Off

Set-off is enforceable in a bankruptcy only if the set-off constitutes current account set-off or if the set-off is in respect of obligations arising from the same cause (or transaction). Therefore, outside of a banker’s right to set-off or combine different current accounts, following the bankruptcy of the trader, set-off may only be available in respect of obligations arising between the creditor and the trader arising out of the same transaction. Set-off in those circumstances may not be available in respect of obligations arising out of different transactions between the creditor and trader, or in respect of multilateral netting arrangements, as are common among participants in a clearing house system.

Call for Unpaid Share Capital

The trustee in bankruptcy may obtain the leave of the court to call for shareholders to pay unpaid share capital up to the amount required to discharge the company’s obligations in full.

Effect on Contracts

A declaration of bankruptcy does not automatically result in the termination of contracts to which the bankrupt trader is party. However, if following the declaration of bankruptcy, the trustee in bankruptcy fails to perform the contract, the other party to the contract may terminate the contract provided that the non-defaulting party has provided the trustee in bankruptcy with a grace period within which to cure the default. The length of the grace period is not specified in the legislation. If the non-defaulting party terminates the contract for the trustee in bankruptcy’s failure to perform, the non-defaulting party will, in respect of the trader’s outstanding obligations, rank as an ordinary creditor in the bankruptcy in competition with other unsecured creditors.

Special rules apply to lease agreements in respect of property from which the bankrupt trader undertakes its business.

Vulnerable Transactions

In addition, any transaction that reduces the claims of creditors generally is liable to be set aside if it occurred during the above-mentioned period and the creditor in whose favour the payment was made or who was otherwise preferred was aware at the time of the transaction that the trader had suspended payment of its commercial debts.

In relation to each transaction mentioned above, a suspect period of two years from the date of the bankruptcy order applies. Accordingly, a trustee in bankruptcy may investigate all transactions of the type mentioned which occurred during that two-year period and seek to have them set aside where that is in the interests of ordinary creditors.

Ranking of Creditors

The payment of the wages of the trader’s employees for the 30-day period prior to the declaration of bankruptcy would appear to rank first in priority.
The owner of property that is leased to a bankrupt trader has a lien for a two-year period. The government also has a lien for unpaid taxes during the two-year period preceding the bankruptcy order. The Commercial Code states that public funds that are used to meet the cost of the bankruptcy may be claimed from the first cash which enters the bankrupt estate with priority over all creditors. In liquidation, the expenses of the liquidator have priority over all debts.

The provisions relating to secured creditors are somewhat unclear. Creditors holding security may commonly enforce their security by sale of the secured assets at public auction, outside of the bankruptcy proceedings. Note that there are restrictions on foreign ownership of certain types of property and in such circumstances the pool of potential purchasers and thus the sale price may be reduced.

There are no rules governing the priority between secured creditors in insolvency proceedings, so the position of creditors with competing security over the same asset is also unclear, although possession is often a key component of some forms of security (i.e., effectively preventing multiple security takers over the same asset), and specialist security registers exist for certain types of assets, such as aircraft and real estate.

**Position of Directors**

As mentioned above, a trader must petition for bankruptcy within 30 days of suspending the payment of its commercial debts. If the trader does not do so, the directors may be guilty of a criminal offence of bankruptcy by negligence.

Also, if following a declaration of bankruptcy, the assets of a company are insufficient to satisfy at least 20% of the company’s debts, the court may, if it considers the directors at fault in accordance with the provisions of the Commercial Companies Law governing the liability of directors, declare the directors personally liable for all or certain of the debts of the company.

Directors will also be guilty of a criminal offence if they:

- have concealed, destroyed or altered the company’s accounts;
- have misappropriated or concealed the company’s property;
- knowingly acknowledged debts that are not payable by the company or withheld documents relevant to the bankruptcy;
- have obtained an advantage through fraud;
- have made a disclosure which is untrue in relation to paid-up capital, distributed fictitious profits or received bonuses in excess of the amount provided for by law or in the company’s constitutional documents;
- have failed to keep accounts sufficient to reflect the company’s true financial position;
- have failed to comply with a request to provide information to, or have deliberately provided untrue information to, a judge or the trustee in bankruptcy;
- after the suspension of payment of the company’s debts, have honoured payment to a particular creditor to inflict harm on other creditors or provided securities or special benefits to any creditors by giving them preference over the company’s other creditors;
have disposed of the company’s goods other than on commercial terms in an attempt to delay a suspension of payment by the company of its debts, or a declaration of bankruptcy;

• have acted in a way which is contrary to law or the company’s constitutional documents.

The Commercial Code also imposes criminal sanctions with regard to creditors in certain circumstances, including where a creditor enters into a clandestine agreement with an insolvent trader following the suspension by the trader of its debts and the arrangement confers a special benefit on the creditor which the creditor knows will be detrimental to the trader’s other ordinary creditors.

Protective Compositions

A protective composition is a court-supervised work-out procedure available prior to the declaration of its bankruptcy or the commencement of its liquidation to a trader whose financial position has deteriorated to a point where it can no longer pay its debts.

It appears that the trader must apply for a protective composition within 20 days of the trader ceasing to pay its debts. A further condition is that the trader has traded continuously during the previous year and has during that time complied with all laws relating to the Commercial Register and the keeping of proper accounts.

The trader’s application to the court for a protective composition must set out:

• the cause of the disruption to the trader’s business; and

• its proposal regarding the satisfaction of its obligations, which proposal must provide for not less than 50% of its obligations to be discharged within three years.

The proposal must be accompanied by certain specified documents, including a document specifying the trader’s creditors and debtors, the amount owed by or to it (as applicable) and collateral existing in relation to same.

If the court approves the application, it will appoint a trustee to administer the arrangement and a judge to supervise the process. A moratorium will apply in relation to claims brought against the trader. Secured creditors may not vote on the composition unless they waive their security.

The trustee must register the decision to open protective composition procedures with the Commercial Register and must publish in two daily newspapers specified by the court an invitation to creditors to attend a meeting to consider the trader’s proposal. Thereafter, creditors must provide the trustee with a statement setting out their claims against the bankrupt trader. The process that follows is similar to that described above in relation to the bankruptcy procedure and will similarly conclude with the court preparing a document setting forth the claims of creditors which have been accepted and ruling on objections. Creditors who fail to submit claims within the prescribed periods lose the opportunity to participate in composition proceedings.

After the court has verified all claims, the supervising judge shall fix a time for the creditors’ meeting to consider the trader’s proposal. The trustee must deposit with the court at least five days before the date of the creditors’ meeting a report on the financial state of the trader, the reasons for its interruption and a list of the names of the creditors entitled to participate in the arrangement proceedings. The trustee’s report must also include the trustee’s opinion...
regarding the trader’s proposal. Presumably, that report will at the same time be made available to creditors entitled to participate in the creditors’ meeting.

The requisite majority for the approval of the proposal for the protective composition at the creditors’ meeting is a majority of creditors holding at least two-thirds of the trader’s debts and entitled to vote. As referred to above, creditors holding security are not entitled to vote in respect of the debt secured by that security unless they waive the same. Where the trader has issued debentures having a value exceeding 20% of total debts, the proposal must also be approved by a general assembly of those debenture holders.

If the protective composition is approved by the requisite majority, it binds all of the trader’s creditors, including the secured creditors.

If the protective composition is passed the court will appoint a controller to supervise the carrying out of the composition in accordance with its terms. Following the approval of the protective composition, the trustee in bankruptcy registers the composition on applicable property registers and such registration will result in the creation of a mortgage over the property recorded in the register securing the payment of creditors in accordance with the terms of the protective composition.

The protective composition will automatically cease in the case of fraud, and where the trader fails to comply with the terms of the protected composition a party may apply for an order for the termination of the composition (and presumably in those circumstances the creditors may petition for a bankruptcy order).

Judicial Compositions

Judicial composition is an involuntary reorganisation proceeding initiated by a judge following a declaration of bankruptcy. A creditors’ meeting is formed and the creditors whose claims have been accepted are invited to vote on a judicial composition of the trader’s debts.

The requisite majority for the approval of the proposal for a judicial composition is the same as that for a protective composition, namely a majority of creditors holding at least two-thirds of the trader’s debts that have been accepted. Creditors holding security are not entitled to vote in respect of the debt secured by that security unless they waive it.

If the judicial composition is approved by the requisite majority, it binds all of the trader’s ordinary unsecured creditors. Secured creditors and preferred creditors are not be bound by the terms of the protective composition unless they have waived their security and participated in the meeting leading to the vote on the judicial composition. Following the approval of the judicial composition the trustee in bankruptcy registers the composition on applicable property registers and such registration will result in the creation of a mortgage over the property recorded in the register securing the payment of ordinary creditors in accordance with the terms of the judicial composition.

Creditors may have the judicial composition set aside in case of fraud or where the trader fails to comply with the terms of the judicial composition.

Termination following Fraud or Failure

If the judicial composition is terminated, the court appoints a judge and trustee in bankruptcy. The trustee may then realise the trader’s assets. Sale proceeds will be distributed: first to meet expenses incurred in administering the bankruptcy, secondly among preferred creditors and thirdly to ordinary creditors ratably according to their claims. There is a degree of overlap between these laws and the laws summarised above in relation to the liquidation process.
Application to Foreign Entities

The UAE courts have jurisdiction to hear bankruptcy proceedings relating to any trader with a branch, agency or office within the UAE, including foreign traders.

The provisions relating to liquidation apply to foreign companies which conduct their principal business in the UAE.

Free Zones

Certain free zones, and most notably the Dubai International Financial Centre (“DIFC”), have enacted their own insolvency laws. DIFC Law No. 3 of 2009 and the related Insolvency Regulations (together, the “DIFC Insolvency Law”) create an insolvency regime that is similar to English law and in particular the Insolvency Act 1986, and provides for company voluntary arrangements, receivership (including the appointment of administer receivers) and liquidation. Generally, the DIFC Insolvency Law relates only to companies incorporated under DIFC Law No. 2 of 2009 (the “DIFC Companies Law”) or registered to carry on business in the DIFC pursuant to the DIFC Companies Law. The DIFC Insolvency Law is generally considered to represent best practice in terms of the insolvency procedures applying in Gulf Co-operation Council jurisdictions.

Dubai World

The financial travails of the Dubai World group of companies are well documented and Dubai World represents the most serious corporate disruption in the UAE’s relatively brief history.

The Dubai World (“DW”) Decree no.57/2009 was issued to facilitate the restructuring of the Dubai World group in the event an informal work-out could not be agreed. The DW Decree is a customised version of the DIFC Insolvency Law but disapplies many of the provisions of the DIFC Insolvency Law, with the apparent intention of ensuring that the restructuring of Dubai World will be carried out in a particular manner. Generally, the DW Decree makes it more difficult to place Dubai World into insolvency and protects Dubai World’s officers from liability for certain forms of misconduct. The DW Decree also incorporates certain important features of chapter 11 of the US Bankruptcy Code.

It is interesting to note that not a single insolvency case was filed by a creditor against any of the Dubai World group of companies and that the majority of the cases filed in the Dubai World Tribunal were financial claims cases.

Despite an important number of cases before the Dubai World Tribunal in 2010 and 2011, the Dubai World Tribunal ceased to be active in 2013.

The DW Decree is necessary because Dubai World is a corporation established by special decree. It is not incorporated under the Companies Law and therefore is not subject to the above-described federal law liquidation, bankruptcy and protective composition regimes.

Conclusions and Additional Observations

With the possible exception of the DIFC, lenders and borrowers are likely to continue to agree standstill and work-out arrangements outside of the existing formal insolvency procedures.

The need for insolvency reform has been widely discussed and we expect the UAE government to respond with a new federal framework at some point in the future.
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Overview and Introduction

This Guide discusses the legal framework in the United States for the restructuring of debt and liquidation of insolvent businesses. The US Constitution specifically provides for a federal bankruptcy system under the jurisdiction of the US federal courts. In addition, the laws of each state provide for certain types of insolvency and dissolution proceedings, either by statute or common law traditions that trace their roots to English common law. The primary focus of this Guide is the United States Bankruptcy Code (the “Bankruptcy Code”), chapters 7 (liquidation) and 11 (reorganization), as state proceedings are generally limited to the jurisdiction of the particular state, while the Bankruptcy Code has nationwide application and in many instances, international reach. The structure of debtor’s and creditor’s rights as provided in the Bankruptcy Code has a profound effect on the structuring of debtor–creditor relationships in the US and can have a similar effect in foreign jurisdictions where US businesses have assets and creditor relations.

In addition, the Bankruptcy Code has also influenced the development of insolvency regimes and regulations in foreign jurisdictions that have adopted some, even if not all, of the key concepts embedded in the Bankruptcy Code.

Applicable Legislation

The Bankruptcy Code is codified in title 11 of the United States Code ("USC"): 11 USC §§ 101–1532. It provides for, among other things, individual and business liquidations under chapter 7, individual and business reorganization under chapter 11 (this chapter can also be used for controlled liquidation), bankruptcy payment plans for individuals under chapter 13 and recognition of foreign insolvency proceedings by US courts under chapter 15. The Bankruptcy Code was adopted in 1978, replacing the former regime under the Bankruptcy Act of 1898, and has survived relatively intact since that time, although significant amendments were made in 1984, 1994 and 2005. The Bankruptcy Code and the Federal Judgeship Act of 1984 created a national system of bankruptcy courts, adjuncts of the Federal District Courts, through which all bankruptcy cases are administered.

A company may also choose to liquidate through dissolution proceedings under the corporate laws of any one of the states. In addition, each state has statutes or common law procedures for placing businesses into receivership, and many provide a statutory framework for an “assignment for the benefit of creditors”, which may be a useful and often more cost-effective mechanism for the liquidation of a business whose assets are primarily located in a single state.

Types of Business Bankruptcy Cases

Chapter 7

A company may elect to be liquidated by a trustee under chapter 7 of the Bankruptcy Code. Upon commencement of a case under chapter 7, an estate, comprised of all assets of the company, is created and a trustee is appointed to administer that estate. The trustee is responsible for collecting and liquidating all estate assets and then making distributions to creditors holding allowed claims against the estate. In this regard, the trustee is also responsible for reviewing all claims asserted against the estate, consenting to the allowance of claims and objecting to claims, as appropriate. The trustee is authorised to pursue and defend any pending litigation and to file new lawsuits on behalf of the estate, including legal actions under the Bankruptcy Code to recover preferences and fraudulent transfers (discussed further below). The trustee’s goal is typically to fully administer the estate and
make distributions to creditors holding allowed claims on a pro rata basis in accordance with the statutory priorities of claims under the Bankruptcy Code, as discussed below.

Chapter 11

A company may elect to restructure and reorganise its business under chapter 11 of the Bankruptcy Code. Upon the filing of a voluntary petition under chapter 11, an order for relief is deemed to be entered. Similar to chapter 7, an estate is immediately deemed to arise, consisting of all of the assets of the company as of the commencement of the case. Absent malfeasance or similar circumstances, the current management of a company remains in control of the company and continues to manage the company’s day-to-day affairs during the chapter 11 proceedings.

A company is not required to be insolvent in order to file for chapter 11 relief and may elect to use chapter 11 in order to effectuate a financial (balance sheet) restructuring, an operational restructuring (or a combination of both), or a liquidation. Chapter 11 can enable a business debtor to implement a balance sheet restructuring by reducing a reorganised company’s debt burden to better align with its ability to generate cash flows to service debt. This often involves a plan of reorganisation that converts all or a portion of existing secured and/or unsecured debt to new equity in the reorganised debtor, and in most cases, effectively cancelling old equity interests. Although less frequent, old equity holders may be permitted to continue to participate in the reorganised debtor, with either warrants or a substantially diluted equity position, provided creditors are paid in full or consent.

A business debtor can also implement an operational restructuring of its business model in chapter 11. This can involve rejecting burdensome executory contracts and leases, selling unprofitable business units and streamlining operations to yield a more efficient business model.

A chapter 11 case can also be used to implement an orderly liquidation of a company, with management remaining in control throughout the liquidation process. This can involve management’s sale of substantially all the assets of the company in one or more sales under § 363 (discussed below). It can also involve the formation of a liquidation trust to pursue causes of action or market and sell illiquid assets for the benefit of creditors over a period of time after a liquidation plan is confirmed.

Important Players in a Chapter 11 Case

There are multiple players in a chapter 11 case that participate in every aspect of bankruptcy cases and are likely to be heard in the negotiations over a proposed plan.

US Trustee

The Office of the United States Trustee, a division of the Department of Justice (the “US Trustee”), is charged with overseeing the bankruptcy system. A local representative of the US Trustee is typically assigned to monitor every chapter 11 case.

The US Trustee is responsible for the appointment of statutory committees of creditors and equity holders in a chapter 11 case, and can be heard on any issue in the case. The US Trustee typically intervenes to ensure compliance with the operating and reporting rules applicable to debtors in bankruptcy, regulate compensation of professionals retained in the case and address concerns regarding overall fairness to creditors.

Creditors’ Committee

In nearly every chapter 11 case, the US Trustee appoints an official committee of unsecured creditors: the creditors’ committee. The US Trustee usually sends out invitations to serve on
the creditors’ committee to the debtor’s 20 largest unsecured creditors, as listed on the petition filed by the debtor at the commencement of the chapter 11 case, and selects from among the largest holders that respond in the affirmative.

Members of the creditors’ committee serve as fiduciaries for the interests of all unsecured creditors during the case and are reimbursed for out-of-pocket expenses incurred. The creditors’ committee may retain counsel, and sometimes financial advisors, at the expense of the debtor’s estate, to represent the interests of unsecured creditors during the case.

**Equity Committee**

In cases where the debtor is not hopelessly insolvent (i.e. residual value may exist for holders of equity interests after payment of creditors), the US Trustee may appoint an official committee of equity holders, usually consisting of holders of the largest amounts of equity securities of the debtor. The members of the equity committee also serve as fiduciary representatives of the interests of equity holders during the chapter 11 case, and are entitled to retain counsel, and sometimes financial advisors, at the expense of the debtor’s estate.

**Other Parties**

Depending upon the circumstances of the case, other active players can include: (i) individual creditor entities, including large unsecured and secured creditors; (ii) committees (official and/or ad hoc) of bondholders, tort claimants or other large constituencies of claimants; (iii) unions; (iv) government agencies, such as the Pension Benefit Guaranty Corporation (if pension liabilities cannot be met), US and state environmental protection agencies, and others; (v) parties to critical executory contracts; and (vi) any other constituencies that may be impacted by the administration of the case or proposed bankruptcy plan.

**Bankruptcy Law Fundamentals**

**Automatic Stay (Bankruptcy Code § 362)**

Upon the commencement of a bankruptcy case, the debtor obtains immediate protection from actions against its assets and operations by virtue of the automatic stay implemented under § 362 of the Bankruptcy Code. By operation of the automatic stay, creditors are prohibited from commencing or continuing litigation against the debtor and are prohibited from attempting to collect pre-petition debts of the debtor. Actions against the property of the debtor, such as foreclosure and similar proceedings to execute against assets of the debtor, are likewise stayed.

Automatic stay is one of the most fundamental debtor protections provided by the Bankruptcy Code. It prevents a “race to the courthouse” by creditors seeking to improve their position in the Bankruptcy Code’s priority scheme, whether by perfecting a secured claim, reducing an unsecured claim to judgment and obtaining a judgment lien, or otherwise obtaining payment ahead of similarly situated creditors. The automatic stay provides a debtor with breathing space to reorganise by allowing the debtor time to address the myriad issues that arise upon insolvency, while concurrently managing the debtor-in-possession through the bankruptcy case. Violations of the automatic stay can result in sanctions, penalties and fines for the offender.

As a theoretical matter, the automatic stay applies to all entities, wherever domiciled, and all property of the debtor, wherever located. Enforcement of the automatic stay, however, is limited by, among other things: (i) the bankruptcy court’s territorial jurisdiction – the US and its territories; (ii) the bankruptcy court’s jurisdiction over persons and entities – those domiciled in the US or that have minimum contacts with the US; and (iii) considerations of
comity with non-US governments that may prevent a bankruptcy court from upsetting non-US government processes, entering orders against non-US persons and adjudicating disputes over property outside of the US. The intricacies of the extra-territorial application of the automatic stay are beyond the scope of this discussion. However, entities doing business with US debtors or that have property in the US (or expect to in the future) should give due consideration before taking actions that may violate the stay, even as regards property and entities in a non-US jurisdiction.

Unless modified by a court order, the automatic stay remains in place throughout the pendency of the case. In most cases, debtors will incorporate a continuation of the automatic stay and injunctions against collection actions in the provisions of their chapter 11 plan of reorganisation to provide for exclusive resolution of all pre-petition obligations of the debtor in the bankruptcy court to the greatest extent possible.

Any party considering adverse action against a debtor should first seek a bankruptcy court order providing relief from the automatic stay. Generally, secured creditors may seek relief from the automatic stay on the basis that their collateral is eroding in value and the debtor is not maintaining the value of their collateral, thereby entitling them to adequate protection from any diminution or relief from the automatic stay to permit foreclosure. Adequate protection may consist of monthly cash payments to compensate for erosion in value, additional or substitute liens on new collateral, or other negotiated protections. Creditors may seek relief from the automatic stay on several other grounds, including that the debtor lacks equity in the collateral property and such property is not necessary to an effective reorganisation.

Sales of Assets (Bankruptcy Code § 363)

Although, as noted earlier, a debtor is authorised to continue conducting its business in the “ordinary course” during a chapter 11 case, it must seek bankruptcy court approval to sell any assets of the estate “outside the ordinary course of business” under § 363 of the Bankruptcy Code (a “363 sale”). Section 363 provides that such sale may be free and clear of all liens, claims and interests under certain circumstances, including by attachment of such liens, claims and interests to the proceeds of the 363 sale at closing. A debtor need only provide a “good business reason” to justify proposing a 363 sale, even if the sale will be tantamount to a liquidation of substantially all of the debtor's assets, with creditors left to assert their claims against the sale proceeds.

For a potential purchaser of assets, a 363 sale provides the best means to obtain clear title within a significantly expedited timeframe. Typically, a 363 sale must be made subject to a market test. The most common procedure is to conduct an open auction of the assets, with a "stalking horse" purchaser first negotiating the terms of a final sale, the terms of which are publicly disclosed and provide the floor bid at the auction. The stalking horse bidder is typically provided with bidding protections, such as a break-up or termination fee and reimbursement of expenses associated with due diligence and negotiation of the stalking horse bid. If the debtor has conducted significant marketing and it is clear that there is only one interested party, or if the value of the assets do not justify an expensive auction process, a 363 sale may be conducted in a private sale, with the material terms of the deal disclosed and subject to objection by creditors and other parties in interest.

A 363 sale is an extremely effective tool permitting the debtor to maximise the value obtained from purchasers by separating the assets from related liabilities, such as secured claims, mass tort claims and successor liability claims, that may cloud title and control of the asset in the hands of the debtor. Claims may take years to resolve, and the 363 sale process permits the asset value to be preserved by removing it from the bankruptcy estate, with related liabilities left for resolution in the bankruptcy process and payment from the proceeds
of the 363 sale. If the asset to be sold is subject to the liens of secured creditors, the proposed sale price must be "greater than the aggregate value of all liens" on the assets, unless the secured creditor’s interest is the subject of a *bona fide* dispute or it consents to the sale. Generally, secured lenders are entitled to “credit bid” their secured liens up to the amount of their allowed secured claim at any 363 sale of the assets which serve as their collateral, as discussed below.

Primarily because of the protracted process and substantial expense associated with a chapter 11 case, and the scarcity of lenders willing to provide debtor-in-possession financing (discussed below), 363 sales of all or part of a debtor’s business as a going concern have become a growing trend. Recent examples include GM and Chrysler, which have provided significant and favourable precedents for the use of 363 sales as effective restructuring strategies. In recent years, lenders have become more reluctant to provide financing for prolonged bankruptcy cases and instead typically impose short financing terms that require a confirmed plan or a 363 sale. Also contributing to the growing trend in favour of 363 sales are the 2005 amendments to the Bankruptcy Code which reduced, among other things: (i) a debtor’s exclusive right to propose a plan of reorganisation to a maximum of 18 months after the filing of the petition; and (ii) the time within which a debtor must decide to assume or reject a lease of commercial real estate to a maximum of 210 days after the filing.

**Assumption or Rejection of Executory Contracts (Bankruptcy Code § 365)**

One of the most powerful weapons available to a debtor reorganising under chapter 11 – and sometimes the primary motive for the commencement of a chapter 11 case – is the ability, under the provisions of § 365 of the Bankruptcy Code, to reject burdensome executory contracts while retaining profitable or beneficial contracts. Specifically, § 365 permits a debtor to: (i) assume favourable contracts and compel performance from counterparties upon cure of pre-petition breaches (even if the contract contains a clause terminating the contract upon insolvency or bankruptcy); (ii) assume and assign contracts to third parties (including, with certain specified exceptions, contracts that contain anti-assignment clauses); or (iii) reject an unfavourable contract, resulting in a deemed breach as of the date of the bankruptcy filing, the damages for which are pre-petition unsecured claims that may be of little cost to the debtor’s business going forward (and of little value to the counterparty).

However, executory contracts cannot be rejected in part: they must be either assumed or rejected in their entirety. Nevertheless, the threat of rejecting an executory contract is frequently a powerful tool to use as leverage in the renegotiation of unfavourable terms, because a debtor can assume a contract “as modified” with consent of the counterparty. Certain rejection claims are capped. For example, claims arising from the rejection of long-term real estate leases are capped at the greater of one year’s rent or 15% of the remaining term of the lease, not to exceed three years. This cap can lead to significant savings, especially for retail companies with numerous burdensome, long-term real estate leases.

In general, a debtor may decide whether to assume or reject an executory contract at any time before the confirmation of a chapter 11 plan, and counterparties must continue to perform pending the debtor’s decision, unless they first obtain relief from the automatic stay to terminate their services. Certain types of executory contracts, however, must be assumed or rejected within specific timeframes. For example, commercial real estate leases must be assumed or rejected within 120 days, subject to one 90-day extension. A counterparty may, at any time, request that the bankruptcy court force the debtor to decide at an earlier date based upon the facts and circumstances particular to that party.
Avoiding Powers

The Bankruptcy Code grants a debtor the authority to avoid certain transfers and make recoveries for the benefit of the estate. These avoiding powers are generally intended to “level the playing field” by avoiding transactions that unfairly benefit certain unsecured creditors that should instead share in recoveries on an equal or pro rata basis with other similarly situated creditors. Toward this end, the debtor’s avoiding powers include the power to:

- set aside preferential transfers made to non-insider creditors within 90 days prior to the petition date and, with respect to insiders, within one year prior to the petition date. Generally, insiders are directors, officers, and other control persons or their relatives, and any affiliated entities, and any insider of those entities;
- undo security interests and other pre-petition transfers of property that were not properly perfected under non-bankruptcy law at the time of the petition date; and
- recover fraudulent transfers, that is, transfers made with actual intent to hinder, delay, or defraud creditors or transfers made for less than reasonably equivalent value while the debtor was insolvent, or was rendered insolvent or left with unreasonably small capital. Bankruptcy courts can look back to transfers within two years of the petition date using the Bankruptcy Code’s fraudulent conveyance provisions and up to four years (or six years in some jurisdictions) using state law.

Claims and Priority

The Bankruptcy Code requires a chapter 11 plan to designate claimants into classes of claims and interest holders for treatment under a proposed plan of reorganisation. The term “claim” is broadly defined and includes a right to payment or a right to an equitable remedy for a failure of performance if the breach gives rise to a right of payment.

Claims in a bankruptcy case are generally afforded the following priority:

- secured creditors – individuals or entities holding claims against the debtor that are secured by a lien on property of the estate;
- unsecured creditors entitled to priority under § 507 of the Bankruptcy Code – for example, those holding claims incurred during administration of the case and that were necessary for or benefited the preservation of the debtor’s estate, certain reclamation claims, or claims with statutory priority over other unsecured creditors (e.g. certain wages, pensions, taxes);
- general unsecured creditors – individuals or entities holding allowed unsecured claims; and
- equity holders – individuals or entities holding interests in equity securities of a debtor (e.g. stock in a corporation).

The Claims Allowance Process

The debtor must file various lists and schedules, including lists of the debtor’s secured creditors, unsecured creditors and equity holders. If the debtor lists its debts as undisputed, non-contingent or liquidated, the claims are allowed in the scheduled amount (unless an objection to the claim is filed later) and a proof of claim need not be filed to evidence the claim.
If a proof of claim must be filed (because the claim was not scheduled, or because it was scheduled as contingent, disputed or unliquidated), then it must be filed before the bar date. In a chapter 11 case, the court will set the bar date after a motion is filed and a hearing is held. Any claim filed after the bar date can be disallowed as untimely.

A proof of claim filed in the case is deemed allowed unless a party in interest objects. If an objection is filed, the claim can be disallowed only after a hearing before the court. If a claim is disallowed, then the claimant cannot obtain a distribution from the estate or the reorganised debtor. The claimant may collect, however, from non-debtor parties such as guarantors.

If a claim is contingent or unliquidated as of the date of the order for relief, the court may estimate the claim. An estimation hearing is essentially a truncated trial to liquidate a pre-petition claim.

After the bar date, the debtor is given an opportunity to object to claims. Objections may be based on, among other things, the following arguments: (i) defences based on state law; (ii) the creditor owing money to the estate that must be returned before the claim is allowed; or (iii) the creditor filing an untimely proof of claim.

Rights of Secured Creditors

Generally, over-secured creditors (whose collateral has a value greater than the amount of the creditors’ lien) are entitled to retain their pre-petition liens on the same collateral (or the proceeds thereof) and to be paid in full plus interest at their contractual rate of interest, provided there are no defects or grounds for the debtor to seek to avoid those liens (e.g. if such liens are unperfected under applicable law or can be set aside as fraudulent transfers or preferences).

However, where a creditor’s collateral is worth less than the face amount of the creditor’s lien, a secured creditor’s claims may be bifurcated, under § 506 of the Bankruptcy Code, into a secured claim up to the value of the collateral and an unsecured claim for the balance. A creditor may avoid the effects of such bifurcation by making an election under § 1111(b) of the Bankruptcy Code to retain the full amount of its lien on the collateral, thereby waiving the right to receive any distributions on the unsecured portion of its claim on confirmation of the plan. This effectively permits the under-secured creditor’s full lien amount to “ride through” the chapter 11 case (avoiding bifurcation under § 506 of the Bankruptcy Code), enabling the creditor to obtain a higher recovery in the future if the collateral increases in value after confirmation of the plan.

If a debtor chooses to sell the collateral in bankruptcy, generally, secured creditors have the right to “credit bid” up to the full face amount of their debt – regardless of the actual value of the collateral securing the debt. This right is preserved whether such sale is via a 363 sale or pursuant to a chapter 11 plan, and even if the collateral is sold pursuant to a chapter 11 plan that otherwise provides the secured creditor with the “indubitable equivalent” of its claim.

Debtor-in-Possession Financing

A debtor can seek to entice lenders to provide debtor-in-possession financing (“DIP financing”) with a range of tools that are routinely approved by bankruptcy courts. First, the debtor can offer administrative expense status to a potential lender. Next, if unable to obtain a loan on that basis, the debtor can offer the proposed lender a super-priority administrative claim (having priority over all other administrative claims). However, lenders typically require more than a simple administrative priority or super-priority claim in order to lend to a company in a chapter 11 because they are typically reluctant to run the risk of administrative insolvency (i.e. insufficient funds to pay administrative claims in full).
At the next level, the debtor may seek court approval to grant the proposed lender a lien on its unencumbered assets or secured by a junior lien on property that is already encumbered by a lien. Even though general unsecured creditors may object and insist upon a showing of necessity for a proposed financing that involves granting liens on unencumbered assets, debtors typically prevail in such cases where they can show a reasonable prospect or likelihood for reorganisation.

At the highest level, a debtor may seek court approval to grant the proposed lender a lien on encumbered assets that is equal or senior to existing liens. However, in this case, the debtor must establish “that it is unable to obtain such credit otherwise”. Further, the debtor must establish that the existing lender is adequately protected notwithstanding the proposed senior or “priming” liens. This typically involves consideration of various factors, including: (i) a valuation of the subject property to assess the nature of any “equity cushion” that may exist; (ii) whether the property is eroding in value; (iii) the nature of payments proposed or available; and (iv) whether the debtor has a reasonable prospect for reorganising. Typically, holders of existing liens would object vigorously to any priming liens on their collateral absent a showing of how their liens are adequately protected.

The Chapter 11 Plan Process

The ultimate goal of a debtor company in chapter 11 is to file and confirm a plan of reorganisation or liquidation. A brief description of the plan process is set forth below.

The Disclosure Statement

A debtor is required to prepare and distribute a disclosure statement prior to solicitation of votes from creditors and equity holders. The disclosure statement must contain adequate information regarding the assets, liabilities and affairs (income, projections, risks, etc.) of the debtor so as to enable the holder of a claim or interest to make an informed judgment about the proposed plan.

The Plan

During the first 120 days after commencement of the chapter 11 case, only the debtor may file a proposed plan. That period of exclusivity may be extended by the court to a date that is not more than 18 months after the petition date. The debtor has an additional 60 days after the filing of its plan to solicit acceptances of the plan from each impaired class of creditors. An impaired creditor is one whose legal rights are altered by the plan, and only impaired creditors may vote on the plan. Therefore, a class of creditors proposed to be paid in full is deemed to accept the plan and is not entitled to vote.

If the debtor fails to file a plan within the fixed deadline, or if the plan is not accepted by the requisite creditors within the deadline for soliciting acceptances, the debtor loses exclusivity and any party in interest may file its own plan.

Contents of a Plan

A proposed chapter 11 plan must meet certain minimum requirements in order to be confirmed. For example, it must:

- designate all classes of claims and interests (substantially similar claims or interests must be categorized in the same class);
- specify which classes are impaired and not impaired;
- specify which classes are entitled to vote (only impaired classes are entitled to vote);
• specify the treatment of all classes;
• treat all members within a class equally;
• provide adequate means to implement the plan; and
• not contain any provisions that violate the Bankruptcy Code.

Plans can provide for a financial or operational overhaul of the debtor’s business that includes sales of assets, modification or refinancing of secured and unsecured debt, assumption or rejection of contracts, amendments to the debtor’s corporate charter, the cancellation of existing stock and issuance of new stock, and the swapping of debt for equity. If the debtor’s business has been sold before a plan has been proposed, it can provide for distribution of the proceeds in a plan of liquidation.

Confirmation of the Plan

In order for the bankruptcy court to confirm the proposed plan, a debtor must meet all of the requirements of § 1129 of the Bankruptcy Code. These requirements include establishing that:

• at least one impaired class has accepted the plan (without counting “insiders”) and that, with respect to any non-accepting class, the requirements for a cramdown have been met (see below);
• the plan meets the “best interests of creditors test”, which requires in essence that each impaired class has either accepted the plan or receives no less than it would receive in a liquidation under chapter 7;
• the plan is feasible (not likely to be followed by a liquidation or need for further reorganization);
• the plan was proposed in good faith; and
• the plan does not violate any provisions of the Bankruptcy Code.

Class Voting on the Plan

With respect to an impaired class of creditors, the class is deemed to accept a plan if voting creditors that hold at least two-thirds in dollar amount and more than one-half in number of the claims in the class vote to accept the plan, excluding any votes not solicited or cast in good faith, as determined by the court on request of any party in interest.

Cramdown

Provided all of the requirements set forth in § 1129 of the Bankruptcy Code are met, the bankruptcy court may confirm a plan notwithstanding the rejection of the plan by one or more classes of impaired creditors, provided the court determines the plan “does not discriminate unfairly” and is “fair and equitable” with respect to each impaired class that has not accepted the plan.

The standard “does not discriminate unfairly” generally means that similarly situated creditors must be treated similarly. For example, the treatment of general unsecured creditors must provide generally equivalent value for the rejecting crammed-down class as for the other classes of general unsecured creditors.
The “fair and equitable” test for a plan cram-down differs for secured creditors, unsecured creditors and equity holders. As the test is applied to unsecured creditors and equity holders, it requires that the members of the class receive property of a value equal to the allowed amount of their claims or that junior classes or interests receive nothing on account of their claims or interests under the so-called Absolute Priority Rule (discussed below).

With respect to secured creditors, the “fair and equitable” test generally requires that the creditor keeps its lien and receives deferred cash payments totalling at least the allowed amount of its secured claim, and that the present value (as of the effective date of the confirmed plan) of the payments to be made equals or exceeds the secured creditor’s interest in the collateral. A plan may also be deemed fair and equitable with respect to secured creditors if it provides for deferred cash payments having a present value equal to the creditors’ allowed secured claim within a reasonable time after confirmation of the plan (e.g. from a proposed sale of assets contemplated in the plan).

**Absolute Priority Rule**

The Absolute Priority Rule holds that if a class is impaired and votes against confirmation of a proposed plan, then the class must be paid in full (including unpaid accrued interest) before any junior class of claims or interests may receive anything of value under the plan on account of their pre-petition claims or interests.

Accordingly, in cases where “old equity” wishes to retain an interest in the reorganised debtor despite paying creditors less than the full amount of their claims, the Absolute Priority Rule can pose significant challenges. Under those circumstances, old equity holders must argue that they are not receiving anything on account of their pre-petition interests but on account of “new value contributed” to the reorganised debtor under the “new value exception” to the Absolute Priority Rule. The existence of the new value exception has been long debated and is still open to legal challenge. But if the court recognises the exception, old equity holders must establish that: (i) they are making a new contribution in money or money’s worth; (ii) the contribution is reasonably equivalent to the value of the interest retained in the reorganised debtor; and (iii) the new value contribution is necessary for implementation of a feasible plan of reorganisation. Even if these requirements are met, the opportunity to invest in the reorganised debtor must be subjected to a market test such that old equity-holders are not receiving an exclusive opportunity to invest in the reorganised debtor on account of their pre-petition interests. The nature and scope of this market test can vary from case to case depending upon the facts and circumstances.

**Effect of Plan Confirmation**

Once the plan is confirmed by the bankruptcy court and becomes effective in accordance with its terms, the debtor’s assets and liabilities are subject to the terms of the plan and all creditors and parties in interest are bound by the terms of the plan, regardless of whether they voted for the plan. Typically, the bankruptcy court retains jurisdiction to enforce the terms of the plan and resolve any disputes arising from the plan or that impact upon distributions to be made under the plan.

If a plan is not confirmed, the debtor and/or other parties in interest may seek to propose an alternative plan, as the debtor’s exclusive period to propose a plan is likely to have lapsed by this point. Parties may also seek to convert the case to a chapter 7 mandatory liquidation if there is no reasonable prospect of reorganisation.

**Chapter 15**

The United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-border Insolvency is intended to serve as a model law for adoption by all countries in
order to harmonise laws governing cross-border insolvencies. The 2005 amendments to the Bankruptcy Code substantially adopted the Model Law as chapter 15. Since its enactment in 2005, chapter 15 has become a well-used technique for the recognition of foreign proceedings in the US. Accordingly, the case law is developed, though not fully mature.

Chapter 15 applies in four distinct circumstances:

- when a foreign court or representative seeks assistance in the US with respect to a foreign proceeding;
- when assistance is required in a foreign country for a case pending in the US;
- when a foreign proceeding and a US proceeding are pending concurrently with respect to the same debtor; and
- when interested parties in a foreign proceeding have an interest in participating in or commencing a case under the Bankruptcy Code.

The foreign representative must petition for recognition of the foreign proceeding pursuant to § 1515, with proof of: (i) the existence of the foreign proceeding; (ii) the appointment of the foreign representative; and (iii) a summary of the foreign proceedings to date. Simply filing a petition for recognition does not subject the foreign representative to the jurisdiction of any court in the US for any other purpose.

If the US court recognises the foreign proceeding, chapter 15 can provide many of the same powers and protections of chapter 11 with less expense than a full chapter 11 proceeding. For example, a debtor can obtain the protections of the automatic stay, pursue avoidable transfers under the laws applicable to the foreign proceedings, conduct discovery, dispose of assets in the US, obtain permanent injunctive relief to implement a foreign bankruptcy/insolvency plan and prevent creditors from attempting to execute, levy or otherwise reach assets in the US.

Assignment for the Benefit of Creditors

In many states, another option that may be available to businesses in financial distress is an assignment for the benefit of creditors (commonly known as an "ABC"). An ABC is an insolvency proceeding governed by state law rather than federal bankruptcy law. An ABC is not a vehicle to reorganise a business, although it may be used for a sale of substantially all of the assets of a debtor to a new entity that continues the business. It is most often used as a process for asset liquidation. An ABC can provide some advantages over a bankruptcy, such as lower cost and increased speed, but also has some disadvantages, such as no ability to sell assets “free and clear” of liens absent the consent or full pay-off of lien holders.

An ABC is commenced by a formal, voluntary transfer of most, and usually all, of the business’s assets to an assignee, in trust, to apply the assets or their proceeds to the payment of creditors, who are the beneficiaries of the trust. Unlike a chapter 7 bankruptcy, in which the trustee is randomly selected or is elected by the creditors, in an ABC the business can select the assignee. Also, in most states, an ABC is an out-of-court process in which the assignee is not obligated to seek court approval for the numerous acts of administration of the trust.

To begin the process, the debtor drafts a trust and assignment for the benefit of creditors agreement. Once the document has been executed by the debtor and accepted by the assignee, actual possession of the debtor’s assets is immediately delivered to the assignee for the purpose of liquidating the assets. Shortly thereafter, the assignee will notify all of the debtor’s creditors that an assignment has been made and the intended disposition of the
debtor’s assets and also include a verified claim form for each creditor to complete and return.

Assignees can operate a business to preserve the value of the assets while a buyer is sought. Typically, the consent of any secured lender is necessary for such interim operations. The assignee will typically sell assets at public auction. It is usual for an assignee to have received a “stalking horse” offer for most of the assets at the commencement of the assignment so that he has a “floor bid” going into the auction. Once the assets have been liquidated, the assignee has a fiduciary duty to distribute the proceeds to the creditors in accordance with the priorities established by law.

The advantages of an ABC include:

• speed – a sale can be achieved in a few days, whereas in bankruptcy it could take 30 to 60 days or more;

• cost – due to the lack of court proceedings, administrative costs are much lower than in bankruptcy; and

• competence – an assignee with experience and knowledge of a business can be chosen instead of a randomly selected bankruptcy trustee.

The disadvantages of an ABC include:

• sales – unlike a 363 sale, there is usually no ability to sell assets free and clear of liens and security interests without the consent or full pay-off of lien holders;

• contracts – an ABC is typically a default under most contracts and, unlike in bankruptcy, contracts may be terminated by the counterparty under any ipso facto clause. Additionally, leases and executory contracts cannot be assigned without the consent of counterparties; and

• automatic stay – an ABC does not provide an automatic stay. However, the assets that have been transferred to the trust are insulated from creditors, which generally deters creditors from pursuing claims outside of the ABC process.
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Venezuela

Overview and Introduction

In Venezuela there are two regimes applicable to insolvent individual merchants and companies: moratorium ("atraso"); and bankruptcy ("quiebra"). This Guide sets forth a description of the main aspects of these insolvency regimes.

In addition to the moratorium and bankruptcy proceedings described below, the following regulated entities domiciled in Venezuela are subject to special insolvency regimes:

- insurance companies authorised by the Superintendent of the Insurance Activity ("SAA") to conduct insurance activities in Venezuela;
- securities intermediaries authorised by the National Superintendent of Securities ("SNV") to conduct securities intermediation activities in Venezuela; and
- banks authorised by the Office of the Superintendence of Banking Sector Entities (also known as the “Superintendent of Banks”) ("Sudeban") to conduct banking activities in Venezuela.

These special regimes are beyond the scope of this Guide.

Applicable Legislation

The insolvency regimes in Venezuela (moratorium and bankruptcy) are governed by the Venezuelan Code of Commerce1 ("Commercial Code"), which sets forth the regulations for the moratorium and bankruptcy proceedings applicable to individual merchants and companies. The Venezuelan insolvency regimes do not apply to individuals who are not merchants.

Moratorium

Moratorium is a benefit that a court may grant to companies and individual merchants whose assets exceed their liabilities but, due to an excusable lack of liquidity, are unable to pay their debts at maturity.

The objective of the moratorium is to grant the debtor a term not exceeding 12 months to satisfy its creditors. The original term may be extended by the court for an additional term of up to 12 months under certain circumstances.

If, during the term of the moratorium, the debtor is unable to satisfy all of its creditors or is not able to reach a settlement with the creditors, the debtor will automatically become subject to bankruptcy proceedings.

Conditions and Requirements to Trigger the Moratorium

Moratorium is available to those debtors whose assets exceed their liabilities (i.e. who are not insolvent), but due to a lack of liquidity cannot pay their debts at maturity.

In order to be eligible for a moratorium, the debtor must show that the lack of liquidity is excusable.

1 Published in Official Gazette No. 475, dated 23 July 1955.
Parties that may Initiate the Moratorium

Moratorium is commenced by the debtor’s petition only. The petition must be filed by the debtor before a competent court.

Main Consequences Arising from the Moratorium

**Management of the Debtor’s Business**

As a general rule, debtors continue to operate and administer their day-to-day business within the scope of the plan for liquidating outstanding debts. Nevertheless, the court imposes several restrictions on the debtor in respect of the management and disposition of its assets. The debtor must obtain prior approval of the court to sell, pledge, mortgage, borrow money, compromise, collect receivables, make payments or perform any other acts which are necessary for the purposes of liquidating its assets and satisfying its creditors. The debtor is also subject to supervision by the creditors’ committee. In addition, under certain exceptional circumstances, the debtor also may be completely deprived by the court of the management of its business.

**Mandatory stay**

One of the main consequences of a moratorium is that debts contracted prior to the moratorium mature by operation of law and become due.

Additionally, non-privileged debts contracted before the declaration of a moratorium are subject to stay and creditors are not entitled to sue for collection of their credits. Conversely, privileged debts and secured debts before the declaration of a moratorium are not subject to stay and secured creditors are entitled to sue for collection and may foreclose on the collateral, during the moratorium.

As a result of the moratorium, debts are automatically accelerated with respect to the debtor, but automatic acceleration does not apply to co-obligors. Creditors whose actions against the debtor are subject to stay may freely collect their mature receivables from the debtor’s co-obligors if the co-obligors are jointly and severally liable with the debtor.

Debts contracted after the declaration of a moratorium are not subject to stay, provided that they have been authorised by the moratorium court and the creditors’ committee.

**Set-Off during the Moratorium**

The general rule in Venezuela is that the set-off of debts and credits takes place by operation of law, provided that: (i) the debtor and the creditor have reciprocal obligations; (ii) each debt consists of money or assets of the same kind; and (iii) both debts are mature. Set-off operates up to the value of the lesser debt. However, there are no statutory provisions specifically regulating the set-off of debts after the moratorium. Therefore, as with many other insolvency issues under Venezuelan law, there is no certainty of result.

In the absence of specific regulations, commentators have almost unanimously held that set-off cannot take place after the moratorium because such a transaction would negatively impact the rights of other creditors of the debtor. These commentators apply Article 1,340 of the Civil Code, which states that set-off cannot operate if it prejudices the rights of third parties.

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2 Civil Code, Articles 1,331 and 1,333.
3 Published in Official Gazette No. 2,890, dated 26 July 1982.
A few Venezuelan commentators support the argument that, as a matter of equity, set-off may take place during the moratorium, provided that the reciprocal debts and credits arise from the same contract. However, we are not aware of case law or judicial precedents supporting this view.

**Preference Period**

Because the moratorium presupposes that the debtor is not insolvent, there is no preference period in a moratorium which may affect the enforceability of transactions executed by the debtor prior to the moratorium. However, when the moratorium is converted into or otherwise followed by a bankruptcy, the preference period could be of up to a maximum of two years and 10 days prior to the bankruptcy decree. Certain transactions executed during the preference period could be declared void or voidable by the bankruptcy court. These transactions are listed below.

**Priorities and Privileges in the Payment of the Debtor’s Obligations**

Because the moratorium is designed to assist the company in reaching an amicable arrangement with the creditors, it does not necessarily involve the liquidation of the assets of the debtor and the distribution of the proceeds thereof pursuant to the rules of priorities. Nonetheless, if assets are liquidated, the distribution of the proceeds follows the order of priorities and privileges applicable in case of bankruptcy, described below.

**Approximate Length and Termination of the Moratorium**

Pursuant to the Commercial Code, the moratorium should not exceed 12 months. This term may be extended by a court under certain circumstances for an additional term of up to 12 months.

A moratorium may be revoked by the court and converted into bankruptcy under any of the following circumstances:

- the existence of debts which were not declared by the debtor in the petition for a moratorium;
- assets listed by the debtor in its petition that, in fact, do not exist;
- failure by the debtor to comply with any obligation imposed by the court during the moratorium;
- the discovery of fraud or bad faith by the debtor; or
- insufficiency of the debtor’s assets to satisfy at least two-thirds of the claims against the debtor.

A moratorium proceeding may be dismissed at any time upon: (i) withdrawal of the petition by the debtor; (ii) payment of all debts; (iii) execution of an agreement with all creditors; or (iv) a court order revoking the benefit. Early termination of the moratorium proceeding under any of these conditions will result in a bankruptcy decree.

**Bankruptcy**

Unlike a moratorium, bankruptcy is neither a protection nor a benefit. In the ordinary course of events, bankruptcy leads to the liquidation of the bankrupt estate by the trustee or receiver appointed by the bankruptcy court.
Bankruptcy may be in any of the three following forms:

- fortuitous, if arising from fortuitous circumstances or *force majeure*;
- negligent, if caused by the negligence or imprudence of the bankrupt; and
- fraudulent, if arising from the fraudulent conduct of the bankrupt.

In case of negligent or fraudulent bankruptcy, the bankrupt is subject to the criminal sanctions provided for in the Venezuelan Criminal Code.  

### Conditions and Requirements to Trigger the Bankruptcy

Bankruptcy is a proceeding applicable to companies and individual merchants that are insolvent. This has been generally interpreted to mean that companies or individual merchants: (i) are generally unable to pay their debts at maturity; and (ii) do not meet the requirements to apply for a moratorium.

### Parties that may Initiate the Bankruptcy

Under Venezuelan law, bankruptcy may be initiated by:

- the debtor. Directors of companies which become insolvent must file for a bankruptcy proceeding within three days after the date of suspension of payments (i.e. the date on which the company becomes generally unable to pay its debts at maturity);
- one or more creditors; or
- a court denying or revoking a petition for a moratorium, or declaring the expiration of the term of the moratorium.

### Main Consequences arising from the Bankruptcy

#### Management of the Debtor’s Business

The debtor’s assets and businesses are administered by the creditors through the receiver. The company is completely deprived of its capacity to manage its assets.

#### Mandatory stay

The mandatory stay in cases of bankruptcy is the same as in a moratorium. In addition, from the date of the bankruptcy decree, interest ceases accruing to unsecured creditors and creditors grandfathered by a civil law general privilege, but continues accruing in favour of secured creditors.

#### Set-Off during the Bankruptcy

The same set-off rules applicable in moratorium proceedings apply in cases of bankruptcy.

#### Preference Period

Certain transactions executed by the debtor during the preference period could be void or avoidable. The preference period is determined by the bankruptcy court and may extend back to a maximum of two years and 10 days prior to the decree.

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4 Published in Official Gazette No. 5,768, dated 13 April 2005.
The following transactions are void if executed by debtors during the preference period, and the bankruptcy court is obligated to declare their nullity:

- gratuitous conveyances of real or personal property;
- creation of security interests, privileges or preferences in respect of pre-existing debts;
- payment of debts prior to maturity (including a payment through a set-off or any other mechanism of payment of debts which are not mature);
- payment in kind of debts payable in cash.

All other payments made by the debtor in respect of mature debts, including any potential set-off, and all other acts for consideration performed by the debtor during the preference period are voidable, provided that the relevant third party had knowledge of the financial condition of the debtor at the time of the transaction. The court has the authority to decide upon the validity or nullity of any transaction that qualifies as a voidable transaction.

Priorities and Privileges in the Payment of the Debtor’s Obligations

The proceeds of the liquidation of the debtor’s personal property must be distributed among creditors in the following order of priority:

- creditors holding labour claims up to certain statutory limits;
- creditors holding claims for legal expenses incurred during the proceedings to preserve the property for the benefit of all creditors;
- creditors holding security interests in specific collateral;
- creditors having claims which enjoy special civil law privileges or liens on personal property by operation of law (e.g. liens on personal property in the possession of the creditor for any amounts due in connection with the construction, maintenance and improvement of such personal property); and
- unsecured creditors.

The proceeds of the liquidation of the debtor’s real property must be distributed among creditors in the following order of priority:

- creditors holding claims that enjoy a special civil law privilege or a lien on specific real property by operation of law (e.g. expenses incurred for the benefit of all creditors in the attachment, deposit or judicial sale of the property; and taxes for the current and preceding year, registration fees and inheritance taxes);
- claims secured by a mortgage with respect to specific mortgaged property;
- creditors holding labour claims, including past due salaries, severance benefits and any other credits arising from an employment relationship;
- creditors having claims which enjoy special civil law privileges or liens on personal property by operation of law; and
- unsecured creditors.
Upon the liquidation of the debtor’s assets, the proceeds thereof must be distributed pursuant to the order of priorities set forth above. Each category of priorities must be fully satisfied before the proceeds of the liquidation may be used for the payment of subsequent categories. However, creditors having priority over specific collateral and who are not fully satisfied with the proceeds of such specific collateral participate in the distribution of the proceeds of other assets of the debtor (with respect to their deficiency claims) as unsecured creditors.

Within the same category of priorities, the proceeds of the liquidation, if insufficient to fully satisfy such category, will be distributed pro rata among the creditors in proportion to the amount of their claims.

Approximate Length and Termination of the Bankruptcy

Bankruptcy terminates with the liquidation of the bankrupt estate by the receiver. In the absence of clear and conclusive regulations, it is not possible to predict the approximate length of a bankruptcy proceeding.

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Vietnam

On 1 January 2015, Law No. 51/2014/QH13 on Bankruptcy, dated 19 June 2014, issued by the National Assembly (the “New Bankruptcy Law”), officially took effect and replaced Law No. 21/2004/QH11, dated 15 June 2004 (the “Old Bankruptcy Law”). The New Bankruptcy Law also covers aspects of bankruptcy procedures from the time of filing procedures at court, subsequent to an observation that an enterprise or cooperative has become insolvent. The procedures under the New Bankruptcy Law can be carried out only after the filing of a bankruptcy case in court.

Applicable Legislation

The New Bankruptcy Law governs all forms of enterprises and cooperatives established and operating pursuant to the laws of Vietnam.

The government’s Decree No. 22 provides guidance for the organization and operation of asset management officers and asset management/liquidation enterprises.

The government’s Decree No. 67/2015 regulates sanctions on administrative violations in the fields of judicial assistance, judicial administration, civil judgment enforcement, marriage and family, and enterprise and cooperative bankruptcy.

On a related note, notwithstanding that New Bankruptcy Law has been in effect for more than one year, Vietnamese authorities have not introduced documents guiding implementation of the new law. Therefore, we understand that documents (e.g. decrees, circulars, resolutions, etc.) guiding implementation of the Old Bankruptcy Law may applicable in some cases. Therefore, the following documents remain relevant as reference material:

- The implementation guidance in Resolution No. 03 issued by the Supreme People’s Court of Vietnam.
- The government’s Decree No. 67, which provides guidance on the process for applying the Bankruptcy Law to special enterprises and the organization and operation of asset management and liquidation teams.
- Decree No. 05, which addresses the bankruptcy of credit institutions. This Decree applies to all credit institutions established and operating pursuant to the 1997 Law on Credit Institutions as amended in 2004, including state-owned credit institutions, joint-stock credit institutions, cooperative credit institutions, joint venture credit institutions and 100% foreign-owned capital credit institutions. The aforementioned credit institutions (except for cooperative credit institutions) may be placed under the “special control” of the State Bank of Vietnam where such credit institutions are in danger of becoming insolvent or being unable to make payments.

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1 Decree No. 22/2015/ND-CP, dated 16 February 2015, on providing detailed regulations of several articles of the New Bankruptcy Law on asset management officers and asset management and liquidation practice (“Decree No. 22”).
2 Decree No. 67/2015/ND-CP, dated 14 August 2015, amending and supplementing some provisions of Decree No. 110/2013, dated 24 September 2013, of the Government on regulating sanctions of administrative violations in the fields of judicial assistance, judicial administration, civil judgment enforcement, marriage and family, enterprise and cooperative bankruptcy (“Decree No. 67/2015”).
3 Decree No. 67/2006/ND-CP of the Government, dated 11 July 2006, guiding the application of Bankruptcy Law to special enterprises and the organization and operation of asset management and liquidation teams (“Decree No. 67”).
4 Decree No. 05/2010/ND-CP of the Government, dated 18 January 2010, regulating application of the Bankruptcy Law to credit institutions (“Decree No. 05”).
5 Law on Credit Institutions 2010, which was adopted by the National Assembly on 16 June 2010 and took effect on 1 January 2011 (the “Law on Credit Institutions”), has replaced the 1997 Law on Credit Institutions as amended in 2004.
• Decree No. 114, which applies to the bankruptcy of the following entities: enterprises conducting insurance business which are established and operating in Vietnam pursuant to the Law on Insurance Business (except for insurance brokers); securities companies, securities investment fund management companies and securities investment companies established and operating in Vietnam pursuant to the Law on Securities; lottery companies conducting lottery business pursuant to Decree No. 30.

For matters which Decree No. 05 and Decree No. 114 do not address, the provisions of the New Bankruptcy Law and its implementing guidelines shall apply.

Personal Bankruptcy

No law on personal bankruptcy is available in Vietnam.

Corporate Insolvency and Restructuring

Court-Based Corporate Insolvencies

Jurisdiction

• The Provincial People’s Court has jurisdiction to settle bankruptcy procedures in the following cases:
  • Those involving overseas assets or entities.
  • Those in which the insolvent entity has branches and/or representative offices located in districts and/or cities of various provinces;
  • Those in which the insolvent entity has real estate in districts and/or cities of various provinces; and
  • Those in which the Provincial People’s Court takes the bankruptcy cases under the management of the District People’s Court due to their complicacy.

The District People’s Court has the competence in bankruptcy settlement for enterprises and cooperatives whose headquarters are located in the district and for cases which do not fall under the jurisdiction of the provincial court.

Initiation and Filing

Proceedings may (and in some cases are obliged to) be instigated by any of the following parties upon observation that an enterprise or cooperative has become insolvent: unsecured or partly secured creditors, employees, internal trade unions (or the superior trade union if the internal trade union is not established), the legal representative of an enterprise or cooperative, the owner of a private enterprise/one-member limited liability company, chairman of the board of management of a joint-stock company, chairman of the members’ council of a multi-member limited liability company, general partner of any partnership; and

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6 Decree No. 114/2008/ND-CP of the Government dated 3 November 2008 providing guidance on the Bankruptcy Law with regard to enterprises in insurance, securities, and other financial sectors (“Decree No. 114”).


8 Law No. 70/2006/QH10 on Securities, issued by the National Assembly on 29 June 2006 as amended in 2010 (“Law on Securities”).

shareholder or any group of shareholders owning at least 20% of ordinary shares for at least six consecutive months, except when otherwise provided by the company’s charter.

A petition to commence bankruptcy proceedings typically includes the following information:

- Name and address of the petitioner;
- Name of the People’s Court in charge of the bankruptcy settlement;
- Name and address of the enterprise or cooperative that has become insolvent;
- Grounds for the request to commence bankruptcy procedures together with supporting documents proving debts have been due for over three months (e.g., receipts, agreement, invoices, etc.); and
- Appointment of an asset management officer or asset management liquidation enterprise (if any).

However, if the petitioner is the legal representative of an enterprise or cooperative or the owner of any private enterprise or the President of the Board of Directors of a joint-stock company or Chairperson of the Board of Members of a multi-member limited liability company or the owner of a single limited liability company or general partner of a partnership or shareholders as mentioned above, they must enclose with the petition the following supporting documents:

- Financial statements of the insolvent enterprise or cooperative for the three most recent years;
- An explanation of the cause(s) resulting in insolvency;
- A report on the results of unsuccessful measures which have been taken to recover the enterprise or cooperative;
- Details and locations of the assets of the enterprise or cooperative;
- A list of creditors and debtors containing their names, addresses, debts, types of loans (secured, unsecured or partly-secured loans) which have become due or have not yet become due;
- The establishment certification and charter of the insolvent enterprise or cooperative; and
- Results of a price appraisal and valuation of remaining assets (if any).

For the submission of the petition, the court will accept jurisdiction over a bankruptcy case from the date on which the petitioner presents a receipt for payment of the bankruptcy fee and a receipt for advance payment of bankruptcy costs.

If the petition for initiation of bankruptcy procedures was filed by creditors, then within three working days from the date of the court’s receipt of the petition, the insolvent enterprise or cooperative may commence negotiations with the creditors for the withdrawal of the petition. The duration of negotiation will be determined by the court, but shall not exceed 20 days from the date of receipt of the petition.

If the petition is not withdrawn, then within 30 days of the date of accepting jurisdiction over a petition for proceeding with bankruptcy procedures, the court must issue a decision to
commence (or not to commence) bankruptcy procedures, based on grounds proving (or disproving) that the enterprise or cooperative has become insolvent within the meaning of the New Bankruptcy Law.

Under the New Bankruptcy Law, any enterprise or cooperative that is unable to pay its due debts over a period of three months shall be deemed to have become insolvent. As such, an enterprise or cooperative shall be considered as insolvent if it fails to repay due debts over the course of three months without having evidence that creditors have demanded payment of due debts and that the enterprise or cooperative has failed to repay as required by the Old Bankruptcy Law. Also, within this definition, we understand that the New Bankruptcy Law extends the payment term for enterprises and cooperatives.

Parties to the case can apply for emergency measures at the same time as an application is filed, in order to prevent the loss or disposal of assets. Such measures include the sale of perishable goods and the freezing of funds or other property of the insolvent enterprise or cooperative.

**Payment of Fees**

Bankruptcy fees are used to fund the bankruptcy procedures. Under the New Bankruptcy Law, insolvency processing costs mainly include: (i) bankruptcy fees: VND 1 million; and (ii) bankruptcy costs consisting of costs for liquidators, costs for audit and public announcements and other expenses which will be calculated by the court. The court will calculate the costs for liquidators under Decree No. 22.

In the event that the petitioner for commencement of bankruptcy procedures is an employee or the grassroots trade union, bankruptcy fees shall be waived.

**Notice**

The New Bankruptcy Law crystallises the requirement of the court to issue notification as to whether the court decides to commence bankruptcy procedures or not.

For a decision to commence proceedings, the court shall give a notice, to be published in two consecutive issues of a local newspaper of the area in which the enterprise or cooperative is incorporated. This notice must also be communicated to the person filling the petition, creditors and debtors of the insolvent enterprise or cooperative, the people’s procuracy at the same level, the civil judicial enforcement office, the taxation authority and the business registration authority of the area in which the head office of the enterprise or cooperative is incorporated.

For a decision not to commence proceedings, the court shall send a notice to the person filling the petition, creditors and debtors of the insolvent enterprise or cooperative, and the people’s procuracy at the same level.

The time limitation for sending notification of the court’s decision is three working days from the date of issuance of its decision to commence or not to commence proceedings.

**Request for Payment of Debts**

Being different from the Old Bankruptcy Law, the New Bankruptcy Law states that, within 30 days from the date of the decision of the court to commence bankruptcy procedures, creditors must submit a notice requesting payment of debts to the asset management officer.
or asset management and liquidation enterprise. The notice must include substantiating evidence of those debts.

Under the New Bankruptcy Law, it is unclear what the legal consequences will be if the notice is not filed prior to the deadline.

**Management of Proceedings**

The asset management officer or asset management and liquidation enterprise is responsible for: (i) verifying, collecting and managing the documents and evidence relevant to the operation of the enterprise or cooperative; (ii) preparing the asset inventory, and list of creditors and debtors; (iii) supervising and inspecting the assets held and preservation thereof; (iv) the recovery, management and distribution of assets; (v) planning for the recovery of assets illegally disposed of; (vi) the depositing of funds received; (vii) and reporting the status of assets, debts and operation of the enterprise or cooperative to the court. Further, it is also to become the representative for the insolvent enterprise or cooperative if the entity has no legal representative.

The asset management officer or asset management and liquidation enterprise shall be appointed in the petition by the petitioner. If the petitioner does not assign, the court conducting the bankruptcy procedures will be responsible for doing so. As such, under the New Bankruptcy Law, the asset management officer or asset management and liquidation enterprise must join in bankruptcy proceedings from the date of issuing the decision to commence the bankruptcy procedures.

The asset management officer must hold a practising certificate as an asset management officer and may be a lawyer, auditor or person having a bachelor degree in law, economics, accounting, finance or banking and five or more years of experience in the field in which he has trained.

Partnerships and private enterprises may play the role of asset management and liquidation enterprise.

**List of Creditors**

Within 15 days from the date of expiry for submission of notices by creditors requesting payment of debts, the asset management officer or asset management and liquidation enterprise must prepare a list of creditors. The asset management officer or asset management and liquidation enterprise must post the list at the head office of the court conducting the bankruptcy procedures and the headquarters of the insolvent enterprise or cooperative and send the same to the creditors for their review. The time limit for the posting is 10 working days. And the creditors, the insolvent enterprise or cooperative may request the court to review the list of creditors within five working days from the date of expiry for posting.

The court shall have three working days from the date of receipt of the complaint to consider the complaint and amend the list of creditors, should it see fit to do so.

**Meeting of Creditors**

Within 20 days from the date of finalisation of the list of creditors or of completion of the inventory of assets, whichever is earlier, the court will convene a meeting of the creditors. The purpose of the meeting is to discuss the financial obligations of the enterprise or cooperative and pass a resolution agreeing to a restructuring plan for payment of debts.

Any creditor (or its proxy) on the list of creditors may attend such a meeting. The meeting will be valid only if: (i) more than half the unsecured creditors are in attendance; and (ii) the
asset management officer or asset management and liquidation enterprise assigned to resolve the petition for commencement of bankruptcy procedures is in attendance.

The meeting of creditors will pass a resolution. The resolution must be in writing and be approved by more than half of the total number of the unsecured creditors who are in attendance, representing at least 65% of the value of unsecured debts.

Corporate Restructuring or Recovery of Business Operations

Thirty days after the above-mentioned meeting of creditors, following the passing of the resolution by that meeting, the enterprise or cooperative must formulate a plan for recovery and submit such plan to the court, creditors and asset management officer or asset management and liquidation enterprise for their opinions.

Within 10 working days from the date of receipt of the plan for recovery of business operations of the enterprise or cooperative, the creditors and the asset management officer or asset management and liquidation enterprise will provide their opinions for the purpose of the enterprise or cooperative’s finalisation. This plan will then be submitted to the asset management officer or asset management and liquidation enterprise for its report to the court.

Within 15 days from the date of receipt of the plan for recovery of business operations of the enterprise or cooperative, the judge settling bankruptcy procedures will review the plan before submission to the meeting of creditors for its consideration and approval.

The plan specifies essential measures for recovery (including the raising of new capital; changes in lines of production, business or technology; restructuring of management; selling of shares or assets and other measures which are not contrary to law) as well the payment of debts.

Within 10 days from the date of deciding to submit the plan to the meeting of creditors, the judge must convene the second meeting. The plan will be approved if it is agreed to by over half of the unsecured creditors present, representing at least 65% of the value of unsecured debts. The court then shall issue a decision to recognise the resolution, and this decision binds all parties.

Following consideration and approval by the judge and meeting of creditors, respectively, the plan shall be implemented and supervised by the asset management officer or asset management and liquidation enterprise. The enterprise or cooperative must report on the status of the plan’s implementation to the asset management officer or asset management and liquidation enterprise in six-month intervals. Following this, the asset management officer or asset management and liquidation enterprise will be responsible for reporting to the judge and notifying creditors.

Upon the report of the asset management officer or asset management and liquidation enterprise and/or the substantial conditions, a judge may issue a decision to suspend the implementation of the recovery plan if: (i) the insolvent entity has completed the recovery plan; (ii) the insolvent entity cannot implement the recovery plan; or (iii) the time-limit for implementing the recovery plan has expired. Otherwise the procedures will be carried out to commence procedures for liquidation of assets (see “Liquidation” below).

Note that in special cases involving state-owned enterprises or those involved in defence or service of the public interest, the debtor organization may receive funding for recovery from the state to ensure its on-going solvency.\(^{12}\) Furthermore, credit institutions in danger of becoming insolvent may be placed under “special control”, a method of direct supervision, by

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\(^{12}\) Decree No. 67, Articles 8 and 9.
the State Bank of Vietnam.13 Termination of such special control by the State Bank of Vietnam will allow such credit institutions, by a court’s decision, to be liquidated and declared bankrupt, without being subject to the business operation recovery procedures.14

**Preservation of Assets**

Under the New Bankruptcy Law, transactions conducted by an enterprise or cooperative that has become insolvent may be deemed to be invalid where such transactions: (i) occur within six months prior to the date the People’s Court issues a decision to commence bankruptcy procedures; and (ii) either (a) comprise the donation, settlement, payment or transfer of assets or debts not due or (b) unduly remove the assets of the enterprise or cooperative.

Further, the New Bankruptcy Law also indicates that transactions of an insolvent enterprise or cooperative which are conducted with related persons within 18 months prior to the date when the People’s Court issued a decision to commence the bankruptcy procedures, may be deemed to be invalid.

Where, at the request of the asset management officer or asset management and liquidation enterprise or any participants in the bankruptcy procedures, the court considers and declares such transactions invalid, any recovered assets are to be included amongst the assets of the enterprise or cooperative within 10 working days.

**Restrictions on Activities**

The business of the enterprise or cooperative continues normally after a decision to commence bankruptcy procedures, but it is subject to the supervision and inspection of the judge and the asset management officer or asset management and liquidation enterprise.

As of the date of commencement of bankruptcy procedures, the insolvent enterprise or cooperative shall be prohibited from undertaking the following activities:

- Concealing or disposing of assets;
- Paying unsecured debts, except for the unsecured debts arising subsequent to the commencement of bankruptcy procedures and paying wages to employees;
- Abandoning or reducing rights to claim debts; and
- Converting unsecured debts into debts secured by the assets of the enterprise or cooperative.

Any transactions as set out above shall be invalid and declared so by the court.

**Declaration of Bankruptcy**

Should the meeting of creditors fail to reach a resolution or should the implemented recovery plan fail, a decision declaring that the enterprise or cooperative is bankrupt (the “Decision”) shall be made by the court.

Within 10 working days from the issuance of the Decision, the court must notify the following parties: person(s) filling the petition, creditors, debtors of the insolvent enterprise or cooperative, the people’s procuracy at the same level, the civil judicial enforcement office, the taxation authority and the business registration authority of the area in which the head office of the enterprise or cooperative is incorporated.

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13 Law on Credit Institutions, Article 146.
14 Decree No. 05, Article 2.2 and New Bankruptcy Law, Article 99 and 104.
This Decision does not exempt the owner of a private enterprise or partner(s) in a partnership from their asset obligations owed to an unpaid creditor, unless otherwise agreed or provided by law.

**Enforcement**

Enforcement occurs where the court’s decision to declare an enterprise or cooperative insolvent is proactively executed by the civil enforcement agency within five working days from the issuance of a decision declaring bankruptcy.\(^\text{15}\)

**Appeal**

An appeal against the Decision may be made within 15 days from the receipt of the court’s announcement by the parties who are notified the announcement. A council of three judges of the immediately superior court shall consider and resolve complaints or protests arising from the Decision within 20 days after receipt of such complaint or protest. The decision of the superior court shall be final in these cases.

**Consequences of Violating the Law**

Any party which commits a breach of the law during the conduct of bankruptcy procedures may be subject to discipline, administrative penalty or criminal prosecution, along with liability for damage caused.

With regard to administrative penalties, the maximum fine for a breach of bankruptcy law is VND 40 million.\(^\text{16}\) In addition, the offender is subject to measures for remedying consequences, such as compulsory compliance with the obligations provided by the bankruptcy law or compulsory return to the status quo which was changed by the breach of bankruptcy law. The court or the head of the provincial-level People’s Committee has the authority to impose administrative sanctions against the offenders.

In addition to the above penalties, owners, partners, directors and those holding managerial positions in the bankrupt enterprise or cooperative are not permitted to establish an enterprise or cooperative or hold the above-mentioned positions during the three years following the date the enterprise or cooperative is declared bankrupt.

**Liquidation**

Should the meeting of creditors fail to reach a resolution or should the implemented recovery plan fail, a decision declaring that the enterprise or cooperative is bankrupt shall be made by the court. Then, within five working days from the issuance of a decision declaring bankruptcy, the civil judgment enforcement office shall be responsible for issuing a decision or assigning an enforcement officer to enforce the decision declaring bankruptcy. Within two working days after receipt of the decision of the civil judgment enforcement office, the enforcement officer must send a written request to the asset management officer or asset management and liquidation enterprise to conduct a liquidation of assets.

Under the New Bankruptcy Law, assets may, but need not, be sold at an auction. However, if the assets are either moveable property valued at at least VND 10 million or immovable property, then the sale will be conducted according to the law on the auction of assets.

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\(^{15}\) Law No. 26/2008/QH12 on Enforcement of Civil Judgments issued by the National assembly, effective 1 September 2009, Article 30.1.

\(^{16}\) Decree No. 110/2013/ND-CP, dated 24 September 2013, of the Government on sanction of administrative violation in the field of judicial assistance, judicial administration, marriage and family, civil judgment enforcement, enterprise and cooperative bankruptcy, effective 11 November 2013, amended and supplemented by Decree No. 67/2015.
Priority of Payments

When the judge conducting the bankruptcy procedures issues the Decision on the declaration of bankruptcy, the assets of the insolvent entity shall be redistributed in the following order:

- Cost of bankruptcy;
- Unpaid salaries, severance pay, social insurance and health insurance to employees, other benefits according to the labour contracts and collective bargaining agreements;
- Debts incurred after the initiation of bankruptcy which are used for resuming business operations; and
- Financial obligations to the government; unsecured debts payable to the creditors on the list of creditors; secured debts which are not paid because the value of collateral is not enough to cover such debts.

If funds remain, they will be owned by the shareholders, partners, and/or owners of the cooperative or private enterprises/one-member limited liability company.

Out-of-Court Mechanisms

There is no codified procedure under Vietnamese law regarding measures available prior to the commencement of formal procedures. However, informal measures may be taken to avoid filing proceedings, including the extension of terms of debts or negotiation with creditors.

Conclusions and Additional Observations

Under the New Bankruptcy Law, it seems that bankruptcy procedures are shorter than those outlined in the Old Bankruptcy Law. This points to a positive development in the innovation of administrative procedures in Vietnam. However, until now, the Vietnamese authorities have not introduced guiding documents, which results in gaps and/or difficulties regarding application.

Bankruptcy procedures are very time-consuming, depending on the complexity of the case and the workload of the court, with recorded proceedings lasting an average of five years. As a matter of practice, bankruptcy procedures in Vietnam usually take longer than what is provided by law.
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