CLIFFORD CHANCE

Clifford Chance
European Insolvency Procedures
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contents

The European Insolvency Regulation

Key Elements:

- Effective since May 2002
- To promote recognition and co-operation between different insolvency regimes of individual member states within the EU
- Unified code for governing law rules
- Concept of "centre of main interests" to determine opening of main proceedings
- Jurisdiction for the opening of territorial or secondary proceedings
- Carve outs include rights in rem and rights of set-off
- Differences in legal regimes for individual member states to remain

Introduction

This note primarily focuses on the insolvency considerations and legislation in specific European jurisdictions However, before considering the individual jurisdictions, it is important to recognise the influence of the pan-European legislation.

The European Regulation on Insolvency Proceedings (Council Regulation 1346/2000) ("the Regulation") came into effect on 31 May 2002. It applies to all EU member states except Denmark (including the European countries that have joined the EU since that date.)

The Regulation does not provide uniform substantive law provisions for members of the European Union. The purpose of the Regulation is primarily to codify how a member state should determine whether it has jurisdiction to open insolvency proceedings, whilst also imposing a uniform approach to the governing law which is applicable to those proceedings. Once these factors have been determined, the procedural rules of the member state in which proceedings are opened will generally apply. The Regulation also provides for the automatic recognition of insolvency proceedings throughout the EU.

Scope

The Regulation applies to all collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator or similar insolvency officeholder. The Regulation primarily applies to corporates and individuals within the member states. This encompasses various corporate entities such as trading companies, special purpose vehicles and group treasury companies. Its scope of application is confined to parties with their centre of main interests within a member state of the EU. (It therefore applies to entities whose place of incorporation may be outside of the EU, but whose centre of main interests is within a member state.)

The Regulation does not apply to entities who do not have their centre of main interests within a member state. The extent to which insolvency proceedings from outside of the EU are recognised, depends upon the domestic legislation and practice of each particular member state. (See the separate sections for individual member states.)

The Regulation does not apply to banks, credit institutions, insurance companies, investment undertakings which hold funds or securities for third parties, or collective investment schemes. The reorganisation and winding up of credit institutions is addressed in Council Directive 2001/24 and the reorganisation and winding up of insurance undertakings is addressed in Council Directive 2001/17. These two directives are beyond the scope of this note.

Jurisdiction

The primary jurisdiction for insolvency proceedings, as provided by the Regulation, is the court of the member state where the debtor's centre of main interests is located. In the case of a company or other legal person, in the absence of proof to the contrary, there is a rebuttable presumption that this is where the registered office of the company is located.

The Regulation allows for the courts in countries other than the home state to open "territorial" insolvency proceedings or, after the commencement of main proceedings "secondary" proceedings, in the event that such debtor possesses an establishment in the territory of such other member state. The applicable law of such territorial or secondary insolvency proceedings will be the law of that other member state. However, territorial insolvency proceedings or secondary insolvency proceedings are limited in scope to the debtor's assets in that member state and so will not extend beyond the member state where they are opened. Furthermore, under the Regulation, secondary proceedings are limited to winding-up proceedings.

Governing Law

The Regulation imposes a unified code for the governing law which, in conjunction with the mandatory regime of jurisdiction rules, aims to enable those who have dealings with a debtor whose centre of main interests is within the EU to identify with greater certainty the substantive legal provisions by which their rights will be determined in the event of the debtor's insolvency. The general rule is that the law applicable to the insolvency proceedings and its effects shall be that of the member state within the territory in which such proceedings are opened.

So, unless secondary or territorial proceedings can be initiated as well, the law of the home state is likely to dominate. Once the proceedings are opened the specific jurisdictional considerations set out in the latter part of this note assume relevance.

The Regulation recognises that there will be cases where strict adherence to the general rule will interfere with the rules under which transactions are carried out in other member states, and therefore the general rule is subject to a number of exceptions and carve outs.

These exceptions include 'rights in rem' including rights of security (to include holders of floating security over a fluctuating pool of assets), rights of setoff permitted by the law applicable to the insolvent debtor's claim, rights under a reservation of title clause, contracts relating to immovable property, rules of payment systems and financial markets, contracts of employment, etc.

Disagreements between Member States

Different jurisdictions may interpret the Regulation in ways inconsistent with each other. This has been apparent from the case law which has been generated since the introduction of the Regulation, which has primarily focused on the determination of an entity's centre of main interests. No guidance is given in the Regulation itself. Different member states' interpretation of what constitutes the centre of main interests has resulted in main proceedings being opened in more than one member state. This is something that the Regulation was designed to avoid.

Any disagreement between member states as to where the centre of main interests is located would ultimately have to be resolved by the European Court of Justice ("ECJ").

Reference to The European Court of Justice

The first significant reference was made in 2004 to the ECJ in respect of the Irish incorporated subsidiary of the Parmalat group, Eurofood IFSC ("Eurofood"). In relation to that company, a difference of interpretation led to two different courts asserting that the centre of main interests for Eurofood was in their respective jurisdictions. The Irish court considered that Eurofood's centre of main interests was in Ireland, based on the following: it was incorporated in Ireland and subject to the fiscal and regulatory controls there; the day to day administration was carried out in Ireland where the company's accounts were also maintained; the company's board meetings took place in Ireland; and, the creditor's perception was that the centre of main interests was in Ireland.

The Italian courts asserted that the centre of main interests was in Italy, based on the following: the company was merely a conduit for the financial policy of the Italian parent; its exclusive point of reference was to the Italian parent; its operating office was in Italy; and, the central management function was carried out in Italy. The Irish Supreme Court referred a number of questions in relation to this issue to the European Court. The ECJ held that the registered office presumption could only be rebutted if there were factors ascertainable by those dealing with the company that objectively established that its administration was conducted elsewhere.

The ECJ further held that the presumption could not be rebutted simply by producing evidence that the headquarters of the parent company (that has the ability to make or influence economic choices for its subsidiary) was elsewhere. It is to be noted that the burden of proof is placed on those seeking to rebut the presumption that the location of the registered office determining the centre of main interests is a high one.

Discrepancies in the interpretation of the Regulation (in respect of extending a member state court's jurisdiction) may in some circumstances result in forum shopping, something the Regulation was designed to prevent. On a positive note, there have been examples where the Regulation has been used to facilitate pan-European restructurings by implementing local compositions in main proceedings.

Review of the Regulation

The EU Commission is obliged to report on the application of the Regulation no later than 1 June 2012. This has been one of the considerations in relation to a draft report dated 6 June 2011 published by the EU Parliament's Committee on Legal Affairs which recommends legislative proposals for the harmonisation of insolvency law. The draft report comprises a request that the European Commission submits to the European Parliament legislative proposals relating to four key areas, namely: the harmonisation of specific aspects of insolvency; revisions to the EUIR; how to approach groups of companies; and the creation of EU insolvency register.

England & Wales

Key Elements:

- Limited application of administrative receivership regime
- Administration procedure with focus on company rescue
- Practical guidance for lenders and shadow directors
- Ranking of claims in different procedures

Introduction

This section is designed to provide a general outline of the main corporate insolvency procedures in England and Wales. Most of the legislation relevant to insolvency is contained in the Insolvency Act 1986 (the "Act") and the Insolvency Rules 1986 as amended by the Enterprise Act 2002 (the "EA 2002").

The main procedures encountered in corporate insolvencies are administrative receivership, administration and liquidation. We also consider very briefly company voluntary arrangements and schemes of arrangement pursuant to the Companies Act 2006. We consider each of these procedures in turn, the legal basis for challenges to antecedent transactions, and the personal liability of directors.

The Banking Act 2009 introduced a special resolution regime to address a situation where a UK bank (a UK incorporated institution with permission to accept deposits under the Financial Services and Markets Act 2000 (a "UK Bank")) or a building society has encountered, or is likely to encounter, financial difficulties. The Banking Act gives H.M. Treasury, the FSA and the Bank of England wide powers to implement stabilisation measures under the Banking Act in respect of a UK Bank and, in limited circumstances, certain matters related to group undertakings of the relevant UK Bank. The powers include the ability to transfer all or some of the property, rights and liabilities of a UK Bank or a building society to a commercial purchaser or a Bank of England entity. The Banking Act also provides for two new special insolvency proceedings, referred to as "bank insolvency" (a modified form of liquidation) and "bank administration" (a modified administration procedure with respect to a residual bank where there has been a partial property transfer to a bridge bank or a private sector purchaser), which may be commenced by specified UK authorities in respect of relevant UK authorised deposit-taking institutions. The Investment Bank Special Administration Regulations provide for further modifications to "bank insolvency" and "bank administration" in certain circumstances for investment banks.

There are also bespoke insolvency regimes for certain other types of companies, for example insurance companies and public utilities. These special regimes are beyond the scope of this note.

Receivership and Administrative Receivership

Administrative receiver

This is a receiver appointed over all or substantially all of the assets and undertakings of the company pursuant to a debenture which includes a floating charge. It is not technically an insolvency procedure, it is an enforcement mechanism used by a secured lender most notably at a time when a company is actually insolvent.

The introduction of the EA 2002 brought about substantial insolvency law reforms. The most significant reform was the prohibition of the appointment of administrative receivers by debenture holders other than pursuant to floating charges created prior to 15 September 2003 and certain other exceptions. The exceptions to the prohibition mean that the administrative receivership regime will still be used as an enforcement mechanism.

Function and duties of receiver

The main function of the receiver is to realise the assets subject to the charge. His duty is to obtain the best price reasonably obtainable at the time of realisation. The receiver owes his primary duty to his appointor, but also has subsidiary duties of good faith to guarantors of the company's debts and to the company. He has very little responsibility to the unsecured creditors of the company and is entitled to act in what he considers to be the best interests of his appointor.

The powers of the receiver

These derive from two sources:

(a) express powers granted in the debenture or charge under which he is appointed; and

(b) statute, as an administrative receiver has the extensive powers conferred by schedule 1 of the Act. It should be noted that schedule 1 does not apply to fixed charge receivers, who have to rely on the express powers in the charge under which they were appointed and the limited statutory powers in the Law of Property Act 1925.

Power to sell charged property

The most significant of the powers of an administrative receiver is the power to dispose of charged property. An administrative receiver has wide powers to dispose of charged property and may do so by public auction or by private agreement. This is generally on such terms as he sees fit. The assets may be sold separately or as part of a sale of the business as a whole. However, since the receiver will generally sell without any warranty or other recourse, the price he can obtain for assets is generally less than that which would be obtained in a normal sale by the company.

Fixed charge receiver

This is a receiver appointed under a fixed charge (i.e. a specific security interest over specific property). His role is to realise security and he is known as a "bare receiver" or "fixed charge receiver".

Administration

Administration is principally a procedure intended to rescue companies which are or may become insolvent. The procedure has been streamlined by the EA 2002. A company can be placed into administration by way of an application to the court for an administration order made by either: the company; or its directors; or by a creditor (including contingent and prospective creditors); or in certain circumstances by a clerk of a Magistrates Court. Administration may also be commenced without the need for a court order initiated by the filing of requisite notices by: the holder of a qualifying floating charge as defined by paragraph 14 of schedule B1 of the Act; or the company; or its directors.

The overriding purpose of an administration is to rescue a company as a going concern. If this is not reasonably practicable, then an administrator may perform his functions with a view to achieving a better result than would be achieved if the company were wound up. Again if this is not reasonably practicable, he may realise the property in order to make a distribution to one or more secured or preferential creditors.

Effect of administration

Administration creates a moratorium during which no insolvency proceedings or other legal proceedings, including enforcement of security, can be taken without the consent of the administrator or the permission of the court.

The effect of this moratorium is to enable the administrator sufficient breathing space to formulate proposals for rescuing the company, or in the event that this does not prove possible, an orderly realisation of the company's assets.

Qualifying charge holder has choice of administrator

A qualifying floating charge holder has the power to choose the identity of an administrator, whether by making the appointment himself (if the floating charge is enforceable) or by intervening in an application to court. An administrator appointed by a qualifying charge holder owes a duty to act in the best interests of the general body of creditors, not simply his appointor. A qualifying floating charge holder may also be able to block the appointment of an administrator in certain circumstances by appointing an administrative receiver (see above).

Powers of an administrator

The powers vested in the administrator are extensive. He is authorised to do all such things as may be necessary for the management of the affairs, business and property of a company. He may dismiss directors. Also, powers of directors which might interfere with the exercise by the administrator of his powers will only be exercisable with his consent. Most importantly, an administrator has the power to sell the assets of the company, even if they are subject to security (see below). He also has the power to make distributions to the creditors of the company (in the instance of distributions to unsecured creditors, he must first obtain the permission of the court).

Property subject to fixed charge

Where the property which the administrator seeks to dispose of is subject to a fixed charge, or is property held by the company under a hire purchase agreement, the administrator is first required either to obtain the leave of the court (who will need to be satisfied that the disposal is likely to promote the legitimate purposes of the administration) or the consent of the charge holder.

It will be a condition of the court permitting the disposal of property subject to a fixed charge or hire purchase agreement that the net proceeds of the disposal must be applied by the company first towards meeting the debt of the secured creditor. The administrator must sell the assets at "market value", failing which he will have to make up the deficiency to the secured creditor.

Property subject to a floating charge

If the security, as created, took the form of a floating charge, the administrator is free to deal with and dispose of the property without permission of the charge holder and without the sanction of the court. The floating charge holder's claims transfer to the proceeds of sale of the charged property but his claims rank after (a) administration liabilities, (b) costs and expenses of the administrator, and (c) claims of preferential creditors.

Importantly the administrator is entitled to use floating charge assets to fund the continuation of the business during the administration. This is one of the reasons why administrators sometimes challenge the legal nature of fixed charges (i.e. contending the charge to be floating rather than fixed).

At the end of the administration, the company may be returned to financial health and continue to trade, be placed into liquidation or dissolved.

Liquidation

There are two forms of liquidation, namely:

(a) winding-up by the court (sometimes called compulsory winding-up); and

(b) voluntary winding-up.

Winding-up by the court

A compulsory liquidation begins by a winding-up order of the court made on the presentation of a petition by a creditor, the company, its directors, or a shareholder.

Grounds for a winding-up order

A company may be wound-up by the court in a number of circumstances although the two most common are:

(a) that the company is unable to pay its debts; or

(b) that the court considers that it is just and equitable that the company should be wound-up.

Although it is unusual for a solvent company to be wound-up by the court, it can happen in certain circumstances on the 'just and equitable' ground. For instance where minority shareholders are being unfairly treated or where there are, for example, only two shareholders neither of whom has effective control and who cannot agree how the affairs of the company should be conducted. Winding-up is, however, an extreme remedy and minority shareholders who are being unfairly treated are usually better advised to seek alternative remedies under section 994 of the Companies Act 2006 which gives the court a broad discretion so that it can, for example, order the purchase of a minority shareholder's shares.

Inability of a company to pay debts

A company is deemed unable to pay its debts if:

(a) a creditor, to whom the company is indebted in a sum exceeding £750 then due, has served on the company a written demand (known as a statutory demand) requiring the company to pay the sum so due, and the company has for three weeks neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor; or

(b) a judgment against the company is unsatisfied; or

(c) it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

In order to obtain a winding-up order it may not be necessary for a creditor to have served a statutory demand on the company or to have an unsatisfied judgment debt, if it has other evidence to demonstrate that the company is insolvent.

A company is also deemed unable to pay its debts if it is proved 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, often referred to as the balance sheet test. A recent Court of Appeal case BNY Corporate Trustee Services Ltd v Eurosail UK 2007-3BL PLC & Ors [2011] EWCA 227, held that in order to invoke the balance sheet test, it would be necessary to consider more than just the audited accounts and that an assessment of whether the company had reached the "*point of no return*" should be carried out, taking into account all the relevant factors in relation to the company.

Provisional liquidation

After the presentation of a petition, where the company's property is in danger or where it is alleged that those in control of the company are misappropriating or wasting the company's assets, an application may be made by any creditor or contributory or by the company itself for the appointment of a provisional liquidator, and the court in a proper case will, at any time before the making of a winding-up order, appoint one.

Duties and powers of the liquidator

The liquidator in a compulsory liquidation is an officer of the court and subject at all times to the control of the court. He is responsible to the creditors for the conduct of the liquidation and remains so responsible until his release as liquidator. The functions of a liquidator in a compulsory liquidation are to ensure that the company's assets are got in, realised and distributed to the company's creditors, and to pay any surplus to the persons entitled to it. The liquidator or the provisional liquidator (as the case may be) takes into his custody, or into his control, all the property to which the company is or appears to be entitled. The powers of the directors cease. The liquidator has very broad powers some of which may only be exercised with the sanction either of the court or of the liquidation committee of creditors. However, the liquidator only has a limited power to carry on the business (to the extent necessary to collect and realise the assets) and in practice it is relatively unusual for a liquidator to achieve a sale of the business as a going concern.

Power of disclaimer

In addition to his general powers a liquidator has a special power to disclaim onerous property. It is important to note that the power to disclaim applies to any unprofitable contract or any other property of the company which is unsaleable, or is not readily saleable, or is such that it may give rise to liability to pay money or perform any other onerous act. Property subject to onerous burdens may be disclaimed even though it is not actually unsaleable. The most typical exercise of disclaimer is in respect of a low value leasehold. The effect of disclaimer is that it effectively terminates the rights and liabilities of the company on the property disclaimed but does not affect the rights and liabilities of any other person. Any interested party is entitled to request the liquidator to decide whether he intends to disclaim and can apply to the court to have the disclaimed property vested in him. A person suffering loss or damage as a result of the liquidator exercising his statutory power of disclaimer, will have an unsecured claim for any loss or damage in the liquidation.

Secured creditors may enforce rights

Although liquidation has the effect of suspending legal proceedings against the company, liquidation does not override the rights of secured creditors who remain free to enforce their security and to retain the proceeds of enforcement in priority to the claims of unsecured creditors.

Unsecured creditors are generally paid *pari passu*, although preferential creditors, as defined by section 386 and schedule 6 of the Act, have a priority over general unsecured creditors and there is a limited class of deferred creditors.

Voluntary winding-up

There are two types of voluntary winding-up, a members' voluntary winding-up and a creditors' voluntary winding-up, the essential difference being that the former applies to solvent companies and the latter to insolvent companies. Accordingly voluntary liquidation is not always an insolvency procedure. Members' voluntary winding-up is often used to effect a corporate reorganisation or reconstruction.

Powers of the liquidator

One consequence of both members' and creditors' voluntary liquidation is that the powers of the directors cease. The liquidator has a number of powers set out in the Act some of which, in the case of a creditors' voluntary liquidation, must be exercised with the sanction of a liquidation committee appointed by creditors, and some of which require the sanction of the court. There are also a number of enabling provisions which entitle the liquidator to, for example, apply to the court for guidance on questions arising in the winding-up. As with a compulsory liquidation, the liquidator's general function is to realise the assets and to pay creditors in accordance with their entitlements (and the liquidator in a voluntary winding-up also has a similar power regarding the disclaimer of onerous property). The order of priority of debts is the same as in a compulsory liquidation.

Company Voluntary Arrangements

A Company Voluntary Arrangement ("CVA") might take the form of a rescue plan or may simply be used to facilitate a distribution to creditors. The objective of such arrangements is to bind dissenting creditors to the proposals.

The Insolvency Act 2000 introduced, amongst other things, a new regime for CVAs of small companies which are eligible for a moratorium period of up to three months when a CVA is proposed by its directors. A small company is one which currently satisfies at least two of the following three requirements: turnover of not more than £6.5m; assets of not more than £3.26m; and less than 50 employees. Although the moratorium is only available to small companies, a CVA can be used by the directors of any company to come to an arrangement with its creditors. For larger businesses that do not qualify for the small company moratorium, the administration process (which has the benefit of a moratorium) may be used in conjunction with a CVA.

There are a number of exceptions and certain companies will not be treated as eligible for a small companies' moratorium, for example, insurance companies, banks, and building societies. During the moratorium, amongst other things, security cannot be enforced and proceedings cannot be commenced or continued against the company or its property except with the consent of the court. Again, the effect of this moratorium is to allow a company time to formulate a proposal so that it can come to an arrangement with its creditors.

The proposal

The proposal cannot affect the rights of secured creditors to enforce their security without the concurrence of the creditors concerned; this effectively gives the secured creditors a veto on an arrangement if it affects their rights. A meeting may not approve a proposal under which a preferential debt of the company is to be paid otherwise than in priority to non-preferential debts, unless the preferential creditor consents to such a change in priority. In order for the proposal to be approved more than one half majority in value of the shareholders and more than three quarters in value of the creditors must vote in favour of the CVA. (Although if the decisions of the creditors and the shareholders differ, the decision of the creditors will prevail subject to the right of a member to apply to the court.)

Schemes of Arrangement

This is not an insolvency procedure but a mechanism contained in Part 26: sections 895-901 of the Companies Act 2006 which allows the court to sanction a "compromise or arrangement" that has been agreed between the relevant class or classes of creditors or members and the company.

A scheme of arrangement binds members or creditors within a class, including unknown creditors who fall within a class of creditors. The power of the majority to bind a minority in the class operates regardless of any contractual restrictions (e.g. requirements for amendments and variations set out in the loan document which governed the debt being compromised.) For the scheme to be approved there needs to be a majority in number, representing three quarters in value, in each class of those voting for the scheme.

A scheme of arrangement requires the sanction of the court to summon a meeting or meetings of the relevant class or classes of creditors or members and is also required to sanction the scheme itself. Assuming the scheme has been approved by the requisite majority of creditors at the meetings, and the scheme is one that an intelligent and honest creditor (or member) would approve, the court should sanction the scheme.

Challenges to Antecedent Transactions

Transactions at an undervalue: section 238 of the Act

An administrator or liquidator may apply to the court to set aside transactions entered into at an undervalue within two years of the onset of insolvency. For this purpose a transaction is at an undervalue if it constitutes a gift or if the value of the consideration received (in money or moneys worth) is significantly less than the consideration provided by the company.

It is a defence to a challenge under section 238 to show that the company was solvent at the time it entered into the relevant transaction or that it was entered into in good faith and that there were reasonable grounds for thinking the transaction would benefit the company. Although historically the view of the court was that granting security did not deplete a company's assets and therefore did not constitute an undervalue, secured creditors should be aware that following the Court of Appeal's decision in Hill v Spread Trustee Company Limited [2006] EWCA 542, the grant of security may now be the subject of a challenge as a transaction at an undervalue.

Preferences: section 239 of the Act

An administrator or liquidator may apply to set aside transactions which occurred within six months of the onset of insolvency (this period is extended to two years for transactions involving connected parties) which had the effect of putting the creditor, surety or guarantor in a better position in the liquidation than would otherwise have been the case and where the company was influenced by a desire to produce that (i.e. preferential) effect. A company must have been influenced in deciding to give the preference by a desire to produce the effect of putting the creditor in a better position. If this desire is missing the security will not be invalidated. It is a defence to a challenge under section 239 to show that the company was solvent at the relevant time (taking account of the effect of the relevant transaction, act or omission).

Transactions defrauding creditors (section 423)

Under section 423 of the Act the court may, on the application of the liquidator of a company (or with the leave of the court, on the application of a "victim of the transaction" even if the company is not in liquidation), set aside a transaction entered into by the company "at an undervalue" if the company entered into the transaction for the purpose of putting assets beyond the reach of a person who is making, or may at some time make, a claim against it or of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make. It is not a condition of the making of such an order that the company was insolvent at the time of the transaction.

A transaction at an undervalue is defined under section 423 of the Act in substantially the same terms as under section 238 of the Act (i.e. lack of/inadequate consideration). The principal differences are:

(a) To set aside a transaction under section 423, the court must be satisfied that it was entered into for the purpose of putting assets beyond the reach of creditors or otherwise prejudicing the interest of creditors.

(b) The remedy is available not only to administrators and liquidators, but also to "a victim of the transaction".

(c) There is no requirement that the company be subject to a formal insolvency proceeding.

Avoidance of floating charges: section 245 of the Act

A charge, which as created was a floating charge, entered into by a company within 12 months (the period is extended to two years if the transaction was in favour of a connected party) of the onset of insolvency is invalid except to the extent of any new money advanced (or the value of goods or services provided) or the discharge reduction of indebtedness which occurs at the same time or on or after the creation of the charge.

It is a defence to a challenge under section 245 to show that the company was solvent when it entered into the charge.

Extortionate credit transactions: section 244 of the Act

An administrator or liquidator may challenge credit transactions entered into within three years of the onset of insolvency if, having regard to the risk accepted by the counterparty, the terms were such as to require "grossly exorbitant" payments (whether unconditionally or in certain circumstances) or if the terms of the transaction otherwise "grossly contravened" ordinary principles of fair dealing.

Personal Liability for Directors

Directors can incur civil and criminal liability for the debts of an insolvent company in a number of ways under the Act. For this purpose, director includes, any person in accordance with whose directions the appointed directors are accustomed to act.

The principal areas of risk for directors are breach of duty, fraudulent trading and wrongful trading.

Breach of duty: section 212 of the Act

This section enables the court on the application of a liquidator, creditor or shareholder to make an order requiring any officer of the company (or any person who has taken part in the promotion, formation or management of the company), liquidator or administrative receiver who has misapplied or mis-appropriated or wrongfully retained money or property of the company or been guilty of misfeasance or breach of any fiduciary duty, to repay or restore the mis-applied or mis-appropriated or wrongfully retained property or contribute to the company's assets by way of compensation for breach of duty.

Fraudulent trading: section 213 of the Act

This section enables a liquidator to apply for contributions from any persons (i.e. not just directors and shadow directors) who were knowingly parties to the carrying on of business with the intent to defraud creditors. The section requires "actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame".

The facts supporting a claim under section 213 will also render every person knowingly party to the carrying on of the business with intent to defraud creditors liable to criminal penalties under section 993 of the Companies Act 1985.

Wrongful trading: section 214 of the Act

A liquidator may apply to the court for contributions towards the assets of the company from any person who held office as a director (this includes shadow directors) from the point at which that person "knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation".

It is a defence to a challenge under section 214 for a director to show that from the point that he knew or ought to have known that insolvent liquidation was unavoidable he "took every step with a view to minimising the potential loss to the company's creditors". This may include directors initiating insolvency proceedings.

It should be noted that resigning does not necessarily enable a director to avoid liability under section 214 and that under section 214 there is no need to prove an intention to defraud creditors.

Part 10 of the Companies Act 2006 codifies the duties of directors. It provides a list of seven general duties aimed to provide greater clarity to directors, and also a non-exhaustive list of factors that directors must take into account when exercising their duties. In particular the factors include a duty to consider not just shareholders, but employees, suppliers, consumers and the environment. The statement of duties in the Companies Act 2006 is not comprehensive. In particular, it does not include the duty which is owed to creditors when the company is insolvent or on the verge of insolvency, though this is preserved.

The Companies Act 2006 also contains a new procedure for enforcement of directors' duties by shareholders on behalf of the company although the claimant must show a prima facie case before being given permission to proceed with a claim. In practice there has not been any increase in litigation to date against directors as a result of these changes to the legislation.

Lender Liability

Generally speaking, the risk in England of lenders being held liable to pay their customers' debts is small. The principal risk for a lender, however, arises where it is found to be acting as a shadow director of a company that becomes insolvent. In such circumstances it is conceivable that a lender may be made liable to make a contribution to an insolvent company's assets for wrongful trading under section 214 of the Act.

"Shadow Director" is defined in section 251 of the Act as meaning "...a person in accordance with whose directions or instructions the directors of the company are accustomed to act (but so that a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity.)"

Consequences of being a shadow director

A liquidator or creditor of an insolvent company might seek to pursue a lender on the basis that it is a shadow director. As previously mentioned, a lender may be made liable to make a contribution to an insolvent company's assets for wrongful trading where it is held to be a shadow director of that company. Wrongful trading occurs from the point in time that a reasonable director ought to have concluded that the company would not avoid insolvent liquidation. From that point on the directors, including shadow directors, run the risk of being ordered to contribute to the company's assets in its liquidation.

Defences available to lenders

One line of defence for a lender accused of shadow directorship lies in the wording of the definition. The directors of the insolvent company are required to be accustomed to act in accordance with directions or instructions received from the shadow director. The word "accustomed" implies that there has been a course of dealings between the parties. If the lender has a constant presence in the company, for example where the lender has appointed a company doctor who is exercising management authority, the position may be different. The key to the definition is the idea that it is the shadow director, not the board of directors, who is exercising the management discretion of the company.

Practical advice for lenders

There is no authority as to what activities are safe for a lender to conduct. This question remains largely unanswered by the courts. Although yet to be tested by the courts, lenders to a company in financial difficulty may be entitled to take action to protect their interests, such as sending in an investigating team; demanding a reduction in the overdraft; demanding security or further security; calling for information, valuations of fixed assets, accounts, cash flow forecasts, etc; requesting the customer's proposals for the reduction of the overdraft, including the submission of a business plan, schedule of proposed sales, etc; advising on the desirability of strengthening management, and seeking fresh capital. In doing all these things the lenders may well expect their demands to be met, firstly because they are likely to be commercially sensible, and secondly because the customer has no option if it wants its facility continued. This should not be sufficient to constitute the lenders being regarded as shadow directors.

So long as the lenders can be viewed to be merely setting out what conditions attach to their continued support they should not incur liability. Crucially, the decision as to whether to continue trading in the face of these conditions, or to cease trading or go into liquidation rests with the directors.

Recent pensions legislation may also affect a lenders' liability where there is a defined benefit pension scheme. Lenders should take care not to become "connected with" or associates of a borrower with such a scheme, as doing so could put them at risk of incurring obligations under financial support or contribution notices issued by the Pension's Regulator. One of the tests of whether a lender is connected or associated is the ability to control one third of the voting rights in a relevant borrower. Security over shares therefore, needs to be carefully drafted to avoid a lender being liable.

Guarantees

Guarantees are available in most circumstances, e.g. downstream (parent to subsidiary), upstream (subsidiary to parent) and cross-stream (between sister companies within a group).

Corporate benefit issues need to be addressed especially in the context of upstream and cross-stream guarantees.

A guarantee is a secondary obligation by a third party relating to a primary obligation by a contracting party (i.e. a borrower under a loan agreement). If the primary obligation is altered, discharged or fails the guarantee may not be enforceable. Usually the document containing a guarantee will also contain a direct indemnity as an independent primary obligation. This should survive even if the guarantee is not enforceable.

A guarantee must be in writing to be enforceable.

Generally speaking, if security or guarantees are granted at the time a loan is drawn, and at that time it is not contemplated that the company will become insolvent, the requisite desire to prefer the creditor/guarantor is usually missing and therefore it should not constitute a preference (see above).

Following the Court of Appeal the decision in Hill v Spread Trustee Company Limited the granting of security/guarantee may be challenged as a transaction at an undervalue (see above).

Priority

Security usually ranks by order of creation, but to preserve the priority position, notice may need to be given. For some assets registration is required in an asset register and security will rank by date of registration.

Subject to the rights of the creditors to agree their relative priority, the order for payment of claims depends upon the type of insolvency procedure.

Broadly speaking in the context of receivership from the charged assets, rank as follows:

(a) Holders of security which ranks prior to the security under which the receiver is appointed;

(b) Holders of security (from the proceeds of which the receiver will recover costs, remuneration and expenses (as prescribed in the charge appointing the receiver));

(c) Preferential creditors (ranks ahead of floating charge only, fixed charges take priority);

(d) Unsecured creditors up to a maximum of £600,000 if the company's net property is £10,000 or more (ranks ahead of floating charge only, fixed charges take priority);

(e) Holders of a floating charge;

(f) Any surplus is payable to subsequent charge holders (if any) or to the company or its liquidator.

Claims in a liquidation commenced after 6 April 2008 will rank as follows:

(a) Holders of fixed charge security (usually dealt with outside of the liquidation process);

(b) Costs and expenses of the liquidation in accordance with the order stipulated by the enacting legislation;

(c) Preferential creditors;

(d) Unsecured creditors up to a maximum of £600,000 if the company's net property is £10,000 or more (payable out of floating charge assets);

(e) Holders of floating charge;

(f) Unsecured creditors;

(g) Post liquidation interest on debts;

(h) Deferred creditors;

(i) Shareholders (only if there is a surplus after the debts are paid).

Claims in administration rank as follows:

(a) Fixed charge security;

(b) Costs and expenses of the administration in accordance with the order stipulated by the enacting legislation;

(c) Preferential creditors;

(d) Unsecured creditors up to a maximum of £600,000 if the company's net property is £10,000 or more;

(e) Holder of a floating charge;

(f) Unsecured creditors;

(g) Post administration interest on debts;

(h) Deferred creditors;

(i) Shareholders (only if there is a surplus after the debts are paid).

New Money Lending

Normally lenders will insist on additional security or priority (ahead of debts incurred prior to the proceedings) before any new monies are advanced to companies after the opening of any insolvency proceedings.

Recognition of Foreign Insolvency Proceedings

Within the EU

The Regulation applies, see first part of this note.

Recognition of foreign insolvency proceedings outside of the EU

The Model Law on Cross Border Insolvency promoted by UNCITRAL was adopted in Great Britain on 4 April 2006 in the form of the Cross Border Insolvency Regulations in 2006. This extends the English court's ability to recognise foreign insolvency proceedings outside of the EU, to jurisdictions such as the US. In addition to the Cross Border Insolvency Regulations 2006 there are statutory provisions allowing the English court to exercise its jurisdiction if the foreign entity has a sufficient connection with England (section 221 of the Act) or if a specific request for assistance is made by the court from one of the territories specified in section 426 of the Act (largely commonwealth countries).

Further, a House of Lords decision in the case of McGrath and others v Riddell and others [2008] UKHL21 held that pursuant to section 426 of the Act, the English Court could direct the remittal of assets realised in an English liquidation to another jurisdiction and absent any manifest injustice to creditors, the English Court has the ability to make an order, even if the effect of that order will facilitate the application of an insolvency regime which differs from English insolvency law. Where remittal is to a jurisdiction whose court cannot make a request pursuant to section 426, the English Court's inherent jurisdiction may only facilitate a transfer where the foreign court's rules do not infringe the principles of English insolvency law.

Under the general principles of comity, foreign proceedings may also be recognised, and in a recent Privy Council decision (which as a matter of English law is persuasive but not binding), Cambridge Gas Transport Corporate v The official committee of unsecured creditors of Navigator Holdings Plc and others [2006] UKPC26, it was held that it was not necessary to open ancillary proceedings in the Isle of Man, to facilitate the implementation of a US plan of reorganisation.

The common law principle that the English courts should provide judicial assistance to persons empowered under foreign bankruptcy law to act on behalf of an insolvent company has also been considered and applied in Rubin & Lan v Eurofinance S.A. and others [2010] EWCA Civ 895, which not only recognised US Chapter 11 bankruptcy proceedings, but also the direct enforcement of default judgments in separate claw back proceedings related to the bankruptcy. It should be noted that this case is pending an appeal to the Supreme Court.

France

Key Elements:

Considers:

- Consensual pre insolvency proceedings: *mandat ad hoc* and conciliation
- Formal insolvency proceedings: safeguard proceedings, accelerated financial safeguard proceedings, rehabilitation proceedings and judicial liquidation
- Creditors' ranking
- Challenge to antecedent transactions
- Liabilities and sanctions

This section is designed to provide a general outline of the main pre-insolvency proceedings and insolvency proceedings in France.

The legislation applying to the insolvency and pre-insolvency proceedings of all private legal entities (limited liability companies, unlimited liability companies, partnerships, trade unions, etc.), individuals conducting a commercial business, craftsmen, farmers and other persons running an independent professional activity, including those having a regulated status (e.g. lawyers, doctors etc.), is contained in Book VI of the French Commercial Code. The relevant proceedings are:

- mandat ad hoc;
- conciliation;
- safeguard proceedings;
- accelerated financial safeguard proceedings;
- rehabilitation proceedings; and
- judicial liquidation.

The objectives of French insolvency law are (i) the preservation of the business, (ii) the preservation of jobs and (iii) the payment of creditors.

The legislation applying to insolvency proceedings of individuals who do no not fall within the scope of Book VI of the French Commercial Code (e.g. employees) and to insolvency proceedings of credit institutions, financial institutions and insurance companies is not described in this section.

The European Regulation on Insolvency Proceedings (the "EUIR") applies, with respect to private international law issues, where the debtor in the insolvency proceedings is not a credit institution, an investment company or an insurance company and the "centre of main interests" (the "COMI") of the debtor is within the territory of a member state of the EU. For cases which do not fall within the scope of the EUIR (e.g. the company's COMI is outside the EU), the rules of private international law essentially stem from French precedents.

Consensual Pre-insolvency Proceedings

Pre-insolvency procedures under French law are *Mandat ad hoc* and Conciliation proceedings. They are intended to facilitate negotiations between the debtor and its main creditors, with a view to reaching an agreement and avoiding the opening of insolvency proceedings.

Debts may only be restructured on a consensual basis in pre-insolvency proceedings, and creditors who refuse to negotiate or to participate in pre-insolvency proceedings will not be affected by any compromise or arrangement reached by the debtor and its other creditors in those proceedings. However, it should be mentioned that under French general civil law, French courts have a general discretion to impose a grace period of up to two years on any creditor: in practice, this possibility can be used as a tool to encourage dissenting creditors to participate in the discussions.

Mandat ad hoc

A debtor that is facing any type of difficulties (but which is not insolvent yet, i.e. which is still able to pay all its due and payable debts with its immediately available assets) may file a petition with the president of the local court having jurisdiction to obtain an order appointing a mediator / advisor called a *mandataire ad hoc* to the debtor. His appointment initiates the pre-insolvency proceedings called mandat ad hoc.

The mandataire ad hoc assists the debtor in its negotiations with third parties (e.g. creditors, employees) and / or helps the debtor assessing its situation (e.g. whether the opening of insolvency proceedings would be appropriate).

The debtor remains in charge of running its business. The mandataire ad hoc does not have the power to interfere in the management of the business.

Mandat ad hoc is not an insolvency proceeding. The existence of a mandat ad hoc is confidential, and will be disclosed only to those parties with whom negotiations need to be conducted. Creditors are not barred from taking legal action against the debtor to recover their claims, but, in practice, they do not usually try to do so.

The debtor may suggest to the court the name of the mandataire ad hoc it would like to see appointed. This suggestion is usually followed by the court. Mandataires ad hoc are generally chosen from the register of insolvency administrators.

The ability of the mandataire ad hoc to help the debtor in its negotiations comes from the fact that he is an independent, court-appointed third party, having significant experience of companies facing financial difficulties. In particular, he is able to explain to the creditors that they also have an interest in finding a consensual solution with the debtor by describing the potential consequences of insolvency proceedings if an agreement is not found. The mandataire ad hoc usually sends written reports to the president of the court, on a confidential basis.

Conciliation

Conciliation is available to debtors that are facing actual or foreseeable legal, economic or financial difficulties, and that are either (a) not insolvent (i.e. are still able to pay all their due and payable debts with their immediately available assets); or (b) insolvent but have been in such a position for a period of less than 45 days.

Conciliation is very similar to mandat ad hoc. In particular:

The debtor can request the appointment of the conciliator ("*conciliateur*") by filing a petition with the president of the local court having jurisdiction. The conciliator will assist the debtor in its negotiations with third parties (e.g. creditors, employees) and / or help the debtor assess its situation (e.g. whether the opening of insolvency proceedings would be appropriate).

The debtor remains in charge of running its business. The conciliator does not have the power to interfere in the management of the business.

Conciliation is not an insolvency proceeding. The existence of a conciliation is confidential, and will be disclosed only to those parties with whom negotiations need to be conducted. Creditors are not barred from taking legal action against the debtor to recover their claims, but, in practice, they do not usually try to do so.

The debtor may suggest to the court the name of the conciliator it would like to see appointed. This suggestion is usually followed by the court. Conciliators are generally chosen from the register of insolvency administrators.

The ability of the conciliator to help the debtor in its negotiations comes from the fact that he is an independent, court-appointed third party, having significant experience of companies facing financial difficulties. In particular, he is able to explain to the creditors that they also have an interest in finding a consensual solution with the debtor by describing the potential consequences of insolvency proceedings if an agreement is not found. The conciliator usually sends written reports to the president of the court, on a confidential basis.

The main differences with mandat ad hoc are the following:

(i) The conciliator can only be appointed for a maximum of 4 months and this period may only be extended by 1 month in exceptional circumstances (i.e. a maximum of 5 months), unlike the mandataire ad hoc whose length of office is at the discretion of the president of the court.

(ii) The debtor cannot enter conciliation again within three months of the termination of the earlier conciliation.

(iii) If the parties reach an agreement (the "Conciliation Agreement"), such agreement can either be acknowledged by an order of the president of the court ("*accord de conciliation constaté*"), or approved by a formal judgment of the court, ("*accord de conciliation homologué*").

In practice, debtors frequently combine the use of mandat ad hoc and conciliation: they first request the opening of a mandat ad hoc (the length of which is very flexible) and, when they believe that they are about to reach an agreement with their creditors, they petition the president of the court to convert the mandat ad hoc into conciliation. Once in conciliation they will be able to seek acknowledgement of the Conciliation Agreement by the president of the court or its approval by a judgment of the court.

Acknowledgement by the president of the court

If the Conciliation Agreement is simply acknowledged by an order of the president of the court, it remains confidential. When he acknowledges the Conciliation Agreement, the president of the court takes formal control of (i) the existence of an agreement – but without controlling the content of such agreement – and (ii) the existence of a declaration from the debtor certifying that he is not insolvent or that, as a result of the execution of this agreement, he is not insolvent anymore. Moreover, the acknowledgment of the Conciliation Agreement by the president of the court makes the agreement enforceable.

Approval by judgment of court

Alternatively, approval of the Conciliation Agreement by a formal judgment gives comfort to the parties thereto in that, if the debtor subsequently goes into insolvency proceedings:

(i) lenders making new money and/or suppliers making trade credit available to the debtor under the Conciliation Agreement will benefit from a priority ranking in those insolvency proceedings; and

(ii) the court may not fix the starting date of the Hardening Period (see Challenge to Antecedent Transactions section below) at a date earlier than the date on which the approval judgment became final.

The drawback of approval by way of a judgment is that confidentiality is lost; only the existence of a Conciliation and a Conciliation Agreement is disclosed in the judgement of approval by the court, not the content of such a Conciliation Agreement. However, such information of the existence of a Conciliation Agreement approved by the court also implies that the debtor, even if he has faced difficulties, has been successfully restructured and is not insolvent (anymore).

Formal Insolvency Proceedings: General Overview

Under French law, a debtor is considered to be insolvent ("*en état de cessation des paiements*") when it is unable to meet its due and payable debts with its immediately available assets (being cash plus assets that can be immediately realised for cash).

The debtor must file a petition with a view to opening a Rehabilitation Proceedings ("*redressement judiciaire*") or a Judicial Liquidation ("*liquidation judiciaire*") within 45 days of the date when it became insolvent (unless it has elected to enter conciliation within such time frame). A petition can also be made by an unpaid creditor, by the public prosecutor or by the court of its own motion. In case a creditor initiates legal action in order to request the opening of Rehabilitation Proceedings or Judicial Liquidation, he has to prove that the debtor is insolvent, which is difficult in practice.

The law further allows the filing of a petition for Safeguard Proceedings ("*procédure de sauvegarde*") that triggers an automatic stay of payments and is aimed at recovery if the debtor establishes that, although not insolvent, he is facing difficulties which he is unable to overcome on its own. If the debtor is insolvent, this procedure will not be available to him.

Drawing lessons from recent experiences, notably the financial restructurings of Autodis and Technicolor (formerly Thomson), a legislation dated October 22nd 2010 introduced into French law the Accelerated Financial Safeguard Proceedings, which has been available to debtors since March, 1st 2011. Accelerated Financial Safeguard Proceedings grant legal basis to financial restructurings. Only financial creditors are involved in the proceedings. In summary, a debtor, the majority but not all of the financial creditors of which support a Conciliation Agreement, has the possibility to enter Financial Accelerated Safeguard Proceedings and impose the arrangement on dissenting minority financial creditors, without affecting its trade creditors.

Accelerated Financial Safeguard Proceedings, Safeguard Proceedings, Rehabilitation Proceedings, or Judicial Liquidation are collectively referred to below as "Insolvency Proceedings".

Insolvency officers

Insolvency Proceedings are essentially court-driven proceedings where most of the key decisions are made or authorised by the court.

In Insolvency Proceedings, an insolvency judge ("*juge-commissaire*") is appointed by the court in the judgment opening the proceedings. He is in charge of taking certain decisions (e.g. admitting claims against the insolvency estate) and authorising certain transactions (e.g. authorising entry into agreements that are not within the ordinary course of business; authorising the sale of assets). However, the court itself retains jurisdiction over key decisions in the proceedings, in particular (i) the adoption of a Safeguard Plan or a Rehabilitation Plan, (ii) the sale of the business as a going concern pursuant to a Sale-of-Business Plan, (iii) the termination of the Insolvency Proceedings, (iv) claims against the debtor (e.g. for mismanagement) and against third parties (e.g. claw-back actions). The public prosecutor is consulted by the court before it takes such key decisions, but the court is not obliged to adopt his position. The public prosecutor is also entitled to initiate certain legal actions.

In Accelerated Financial Safeguard Proceedings, Safeguard Proceedings and Rehabilitation Proceedings, an administrator ("*administrateur judiciaire*") (selected from the register of insolvency administrators) is generally appointed by the court to assist, supervise or, under exceptional circumstances in the case of Rehabilitation Proceedings, replace the debtor in the management of the business. However, it is possible for the court not to appoint an administrator if that does not seem necessary considering the size of the estate of the debtor. In parallel, the court also appoints a representative of the creditors ("*mandataire judiciaire*") (selected from the list of registered *mandataires judiciaires*) who is in charge of (i) receiving and verifying the proofs of claims, (ii) initiating legal actions on behalf of the creditors as a whole (e.g. claims against the directors of the insolvent company), and (iii) more generally, defending the general interest of creditors.

In Judicial Liquidation, a judicial liquidator ("*liquidateur judiciaire*") (selected from the list of registered *mandataires judiciaires*) is appointed by the court. He represents the debtor and he is also entitled to initiate legal actions on behalf of the creditors as a whole. He also receives and verifies the proofs of claims.

Up to five creditors can be appointed as controllers ("*contrôleurs*") if they so request. The role of controllers is dual: they have a general assignment to supervise the proceedings as well as a duty to assist the representative of the creditors in its function (especially during the phase of verification of debts) as well as the insolvency judge in his supervisory function. This appointment gives controllers privileged access to information. Controllers are entitled to initiate legal actions on behalf of the creditors as a whole if the creditors' representative fails to do so.

Purpose of insolvency law

French insolvency law is aimed essentially at the preservation of the enterprise and of employment (by rescue of the company or of the business of the company) and to a lesser extent the repayment of the creditors.

The possible outcomes of Insolvency Proceedings are as follows:

(i) If recovery is possible, the court will permit the debtor to prepare either a "Safeguard Plan" (in the case of Accelerated Financial Safeguard Proceedings and Safeguard Proceedings) or a "Rehabilitation Plan" (in the case of Rehabilitation Proceedings) which in each case will provide the measures necessary for the rehabilitation and continuation of the operations of the debtor.

(ii) If the debtor is unable to prepare a viable Safeguard Plan or Rehabilitation Plan, the court can order the sale of the business as a going concern (free of debts, and including employees and key contracts) to a third party (who must be independent from the debtor), in a so-called "Sale-of-Business Plan" ("*plan de cession*").

(iii) If recovery is manifestly impossible, the court must order the opening of a Judicial Liquidation.

Outcome of Safeguard Proceedings and Rehabilitation Proceedings

The process for implementing a Safeguard or Rehabilitation Plan is essentially as follows:

(i) In both Rehabilitation and Safeguard Proceedings, after verifying the eligibility of the debtor to enter the relevant proceedings, the court orders the commencement of a time period during which the debtor continues to operate its business under the protection of the court whilst its financial and business situation is assessed and an arrangement with creditors is sought. This time period is known as the observation period ("*période d'observation*"). The observation period may initially last for up to 12 months and may be extended so that its maximum total duration is 18 months.

(ii) The proposed restructuring of the debt must be approved, where applicable, by creditors' committees (see below). Each creditor committee acts by a majority of two thirds of creditors present and such majority is empowered to approve a compromise and/or a repayment schedule that is binding on their members.

(iii) If there are no creditors' committees or if the proposed restructuring of the debt is not approved by the creditors' committees, and in all cases, with regard to creditors who are not members of creditors' committees, the court may impose a rescheduling of the debt which cannot exceed 10 years (15 years for agricultural businesses). The court is not empowered to reduce a debt at its own initiative.

Outcome of a Judicial Liquidation

Alternatively, the court may decide that recovery is impossible, and order that Judicial Liquidation be opened in respect of the debtor. The court can order Judicial Liquidation either (i) from the beginning of the relevant Insolvency Proceedings without allowing an observation period where the debtor is insolvent and any recovery is obviously impossible, or (ii) at any time during the observation period if it becomes obvious that recovery is impossible.

In a Judicial Liquidation, the debtor's assets are realised and the proceeds from those realisations are distributed among the creditors according to their respective priority ranking.

The court may approve a "Sale-of-Business Plan" if it determines that the debtor's business can be realised as a going concern. Under such a plan the court may approve the sale of all or part of the business and assets of the debtor, as a going concern, preserving a certain number of employment positions.

If the court considers that no sale of the business as a going concern is likely to take place, the assets can be realised piecemeal.

Automatic stay of payments and other restrictions on rights of creditors

During Insolvency Proceedings, the rights of the creditors are restricted, *inter alia*, as follows:

(i) subject only to very limited exceptions, the debtor may not repay any debts incurred prior to the insolvency judgment;

(ii) as a principle, the commencement of Insolvency Proceedings freezes all legal actions of creditors to enforce a payment obligation incurred prior to the insolvency judgment or to enforce security over the assets of the debtor (any enforcement proceedings filed by creditors in respect of movable and immovable properties shall be stayed or prohibited). However there are some limited exceptions to this rule even during an observation period; and some secured creditors recover their right to enforce their security arising if the debtor is placed in Judicial Liquidation;

(iii) contracts cannot be terminated for reasons originating prior to the insolvency judgment, and clauses providing for termination or acceleration in the event of insolvency are of no effect;

(iv) insolvency officers have the power to choose which agreements entered into by the debtor prior to the insolvency judgment should continue. Contracts which an insolvency officer elects to continue must be performed in accordance with their terms;

(v) creditors must prove their claims arising prior to the judgment opening Insolvency Proceedings within 2 months (4 months for creditors residing outside of France) from the date of publication of such judgment in the designated legal gazette. Where the creditor has failed to file its proof of debt in a timely manner, it will not be allowed to participate in the distribution of proceeds. Certain post-judgment claims must also be proved;

(vi) the right to set off reciprocal debts with the insolvent debtor is limited to "related debts" ("*créances connexes*") i.e. debts which arose in the framework of the same contract (or, to a certain extent, of the same group of contracts); and

(vii) when the Insolvency Proceedings are closed and there is a shortfall between the assets of the debtor and its liabilities, the remedies of the creditors to obtain repayment are, as a general principle, extinguished even if their claims were not satisfied in full. This is subject to certain exceptions e.g. fraud, "insolvency second offenders", etc.

During Accelerated Financial Safeguard Proceedings, such restrictions concern the rights of financial creditors only (credit institutions' committee and, as the case may be, bondholders' committee). Neither suppliers, nor public creditors such as tax or social security administrations are directly impacted. Their debts continue to be due and payable according to their contractual or legal terms.

Safeguard Proceedings

Safeguard Proceedings are only available to debtors which, although not insolvent, establish that they are facing difficulties which they cannot overcome. The purpose of Safeguard Proceedings is to facilitate a restructuring of the debtor while its difficulties are still at an early stage in the framework of formal proceedings.

The judgment opening the proceedings stays all individual claims of creditors, irrespective of their rank, subject only to very limited exceptions such as enforcement of retention of title clauses, set-off of related debts, rights of retention attached to certain security interests. The judgment opens an observation period of a maximum duration of six months, renewable once, and exceptionally twice, for the purposes of preparing and submitting to the approval of the court a Safeguard Plan restructuring the debts and the business. The judgment approving the plan ends the observation period.

The court appoints an administrator to assist and supervise the debtor, but the rationale is to allow sufficient flexibility to enable the management of the debtor to remain in possession. The debtor has the possibility to suggest the name of an administrator to the court.

In contrast to Rehabilitation and Liquidation Proceedings, Safeguard Proceedings do not provide for simplified redundancy procedures, and the redundancy regime is the same as for a non-distressed business. Safeguard Proceedings are therefore more appropriate for financial restructurings and debt work-outs (e.g. over-leveraged situations, distressed LBOs, etc.) rather than industrial reorganisations requiring not only debt restructuring but also broad scale redundancies. Since March 2011, the new Accelerated Financial Safeguard Proceedings could appear to be the most appropriate procedure in cases where the debtor has to restructure financial debt.

However, if a redundancy scheme is needed, and if the debtor is not in a position to finance the cost of its implementation, a state-organised insurance scheme will provide the necessary financing to the debtor, subject to certain criteria and limitations. The repayment of the advances made by the insurance scheme must be made within a limited period of time, which is to be agreed with the insurance scheme, and is generally one to two years after the approval by the court of the Safeguard Plan.

Safeguard Proceedings provide for the creation of at least two creditors' committees, if the debtor (a) has more than 150 employees or (b) has a turnover of more than €20,000,000 and (c) its accounts are certified by a statutory auditor or carried out by a certified public accountant. Nevertheless, the Insolvency Judge can decide to create committees even though the thresholds are not met.

The first committee is comprised of creditors who are the main suppliers of goods and services. The second committee is comprised of creditors that are credit institutions and "assimilated" institutions in particular banks, local public credit institutions, finance companies ("*sociétés financières*") or special purpose financial institutions, the assignees of bank debt that occurred prior or after the opening of proceedings (e.g. hedge funds), as well as any entity granting credit or advances in favour of the debtor (and any entity having been assigned with a debt). If there are bondholders, a "third" committee comprising all bondholders ("*assemblée unique des obligataires*") must approve the plan that has been voted by the two creditors' committees.

The powers of the committees are mainly to approve or reject the debtor's restructuring proposal. The debtor has a wide flexibility in structuring such proposals. In particular, these proposals may include the debt being written off or the partial closure or disposal of the business. The draft Safeguard Plan can provide for the rescheduling of the debts of the members of the committees over a period longer than ten years, and there is no requirement that the debt be reduced by a certain amount within a certain period. Since reform legislation was passed in 2008, the plan can provide for debt-for-equity swaps in certain circumstances. The law provides for the possibility to treat creditors of a same committee differently if the objective economic situation so requires.

Since the law dated October 22nd, 2010, the draft financial restructuring plan must take into consideration subordination agreements concluded before the opening of insolvency proceedings. Thus it is now officially recognized that restructuring plans have to reflect the priority among creditors. However, the legislation is not explicit in relation to whether the plan should fulfill all the provisions of such agreements. Creditors can make counter proposals to the debtor and to the administrator, but the debtor has no obligation to take them into consideration when submitting the plan to the committees. Creditors do not participate to the vote on the draft Safeguard Plan in circumstances where:

(i) their claim is not impacted by the plan or,

(ii) the proposed plan set out the complete reimbursement of their claim when the plan is adopted or when their claim is admitted.

The last reform of French insolvency law dated October 2010 could be considered as a first step to be followed by a reform of the composition and functioning of the creditors' committees in safeguard proceedings. The distinction between the credit institutions' committee and the bondholders' committee appears to be somewhat artificial and does not reflect the fundamental difference between secured, unsecured and subordinated creditors. A solution that is currently being discussed would be to merge the committee of credit institutions with the general assembly of bondholders. It is also further discussed to create homogeneous classes of creditors, and to allow French courts to force confirmation of a plan over the objections of some dissenting classes of creditors, as it is provided under US law.

Within each committee, approval is achieved by a majority of two thirds in value of creditors present who voted on the plan. Dissenting creditors are bound by the decision of that majority. Each of the creditors' committees must have approved the plan before it will be adopted by the court. After having discussed with the debtor and the administrator, the committees must take a decision on the proposed Safeguard or Rehabilitation plan within 20 to 30 days following the submission of the proposals by the debtor. The decision of the committees on the Safeguard Plan must take place within 6 months following the opening of the Safeguard Proceedings or Rehabilitation Proceedings. If all creditors' committees have not approved a Safeguard Plan within this 6-month period, they no longer have any role in the proceeding.

In parallel, non-committee creditors are consulted individually on the options for the payment of their claims (e.g. reduction of the debt with shorter deferral or full repayment over a longer period). The court cannot impose a reduction of the debt on creditors refusing the debtor's proposals, but only a rescheduling or deferral of payment. The rescheduling cannot exceed ten years. After the second year, the minimum annual instalment is 5% of the total liabilities (except in the case of agricultural businesses).

State creditors (such as the tax administration) are not members of any of the creditors' committees. They may however waive or reduce their debt. Rescheduling of their debt can also be imposed, under the conditions mentioned above.

After approval of the Safeguard Plan by the committees, and before sanctioning the plan, the court must satisfy itself that the interests of all the creditors (which includes minority committee creditors) are sufficiently protected. After the sanction of the Safeguard Plan by the court, all members of the committees are bound by the plan. At the same time, the court acknowledges any waiver of debts granted by non-committee creditors and/or orders a rescheduling or deferral of payment of their claims.

If all creditors' committees have not approved a draft Safeguard Plan within 6 months of the opening of the Safeguard Proceedings, or if the Court has refused to sanction the draft Safeguard Plan, all creditors are consulted individually on the options for the payment of their claims (according to the rules described above for consultation of non-committee creditors).

At any time during the observation period, the court can convert the Safeguard Proceedings into either Rehabilitation Proceedings or Judicial Liquidation, if it is shown that the debtor was actually in a state of cessation of payments when it applied for Safeguard Proceedings, or if the debtor finds itself in a state of cessation of payments after the opening of the Safeguard Proceedings. At the request of the debtor, the court also may order the conversion of Safeguard Proceedings into Rehabilitation Proceedings if the adoption of a Safeguard Plan appears impossible and if the termination of the Safeguard Proceedings would lead, without doubt and rather quickly, to the debtor's insolvency.

Accelerated Financial Safeguard Proceedings

This new procedure enables a debtor to implement a restructuring plan without affecting the position of its non-financial creditors. Only financial creditors will be involved with such a procedure. One of the main advantages of the Accelerated Financial Safeguard Proceedings is the fact that it has European-wide recognition under EC Regulation n°1346/2000 (unlike Conciliation, Safeguard Proceedings have been mentioned in Annex A of the Regulation).

This reform resolves a practical issue. In the framework of French pre-insolvency proceedings (*Mandat ad hoc* and Conciliation), the unanimous consent of creditors whose claims are being restructured is necessary. The only way to impose a restructuring on dissenting creditors was to commence an "ordinary" Safeguard Proceedings which involves all creditors, including the debtor's suppliers.

The main differences between the new Accelerated Financial Safeguard Proceedings and the "ordinary" Safeguard Proceedings are the following:

Scope

The Accelerated Financial Safeguard Proceedings have been designed to "fast-track" purely financial difficulties of large companies (with more than 150 employees or turnover greater than €20 million). Thus, only "financial creditors" (mainly credit institutions and bondholders) are involved in the procedure. The other creditors are not affected. Therefore, unlike in "classical" Safeguard Proceedings, no suppliers' committee is created: only the credit institutions' committee and the bondholders' committee will vote on the financial restructuring plan.

Features

Accelerated Financial Safeguard Proceedings enables a debtor to move from the Conciliation into the accelerated procedure when it has proved to the court that the restructuring plan has good chances of being approved by a majority of two thirds of the claims in both the credit institutions' committee and the bondholders' committee.

For the purposes of the proceedings, the conciliator is appointed judicial administrator and the court which has opened the Conciliation also has jurisdiction for this procedure.

Regarding the filing of claims, the situation is different depending on whether creditors have participated or not in the Conciliation. Those who have participated are deemed to have filed their claims to the creditors' representatives. Nevertheless, they have the possibility to update the amount of their claims. Those who were not involved in the Conciliation have to file their claims in the ordinary way.

Duration

The duration of the Accelerated Financial Safeguard Proceedings is shorter than that of "ordinary" Safeguard Proceedings, which generally take between 6 and 18 months. The French Commercial Code provides that the Accelerated Financial Safeguard Proceedings cannot take more than a month from the opening of the procedure (with a possible extension of one month).

Rehabilitation Proceedings

Rehabilitation Proceedings are available to debtors that are insolvent but whose business appears viable.

Such proceedings are commenced by a judgment, which is rendered either at the debtor's request or upon request of an unpaid creditor, of the public prosecutor, or of the court itself. It should be stressed that the debtor has a duty to file a petition with a view to the opening Rehabilitation Proceedings or of a Judicial Liquidation within 45 days of the date when it became insolvent (unless it has elected to enter conciliation within such time frame).

Most of the organisational provisions of Safeguard Proceedings apply to Rehabilitation Proceedings (in particular the limitations imposed on the rights of the creditors). The administrator is required to make an assessment of the company's financial situation, the causes of that situation and the potential solutions e.g. whether the business should be continued under a Rehabilitation Plan (similar to a Safeguard Plan), assigned in whole or in part to a third party or put into liquidation. Depending on the scope of his duties, as determined by the court, the administrator may either assist or replace the debtor in the management of its business and assets.

As in Safeguard Proceedings:

(i) the observation period can last for up to 12 months with an exceptional additional extension of 6 months upon request of the public prosecutor (i.e. a maximum of 18 months);

(ii) the creditors' committees are consulted and can compromise the debt of their members in the same manner as with the Safeguard Proceedings; and

(iii) if the creditors' committees do not approve the proposals of the debtor for the reorganisation of the debt in the framework of a Rehabilitation Plan, all creditors are consulted either individually or collectively on the options for the payment of their claims (see above).

The law provides for expedited redundancy procedures in the case of Rehabilitation Proceedings. If the debtor is not in a position to finance the redundancies, a state organised insurance system provides the necessary financing, subject to certain criteria.

For a Rehabilitation Plan to be approved by the court, the debtor must show that its recovery scheme is viable, and on the basis of the past and forecasted operations' accounts, that the debtor will be able to generate sufficient operational profits to repay the rescheduled liabilities and finance its day-to-day operations and business plan.

A significant difference between Rehabilitation Proceedings and Safeguard Proceedings is that, if the debtor proves unable to prepare a viable Rehabilitation Plan, the court may impose the sale of part or all of the business as a going concern, under a Sale-of-Business Plan (see below). If this route is taken, the administrator makes a call for tender, and the court chooses the offer that best meets the three goals provided for by the law.

At any time during the observation period, the court can order the Judicial Liquidation of the debtor, if the business appears not to be viable.

Judicial Liquidation

A debtor must file a petition for Judicial Liquidation within 45 days of becoming insolvent where recovery through a Rehabilitation Plan is not possible (unless it elects to enter Conciliation within such time frame).

The court appoints a liquidator, who exercises all the powers of management and also represents the general interest of the creditors. He must realise the debtor's assets at the best available price and distribute the proceeds to the creditors.

The assets will be sold either pursuant to a Sale-of-Business plan ("*plan de cession*") or piecemeal.

Liquidation by means of Sale of Business Plan

If the court determines that the debtor's business can be sold as a going concern pursuant to a Sale-of-Business Plan, the liquidation judgment imposes a time period for the implementation of such sale (3 months, renewable once upon request of the public prosecutor). In other words, in the judgment opening Judicial Liquidation, the court may, instead of pronouncing a discontinuation in the activity of the debtor (which is the case in principle), authorize the maintenance of the activity if the debtor's business (or part of its business) can be sold as a going-concern or if it is in the public or the creditors' interest. Therefore, the possibility to sell the debtor's business is contemplated during the hearing at which the company enters into liquidation proceedings.

During such time period the debtor basically operates its business as if it were within an observation period (as per Safeguard Proceedings or Rehabilitation Proceedings). The court may decide that an administrator remains in office in addition to the judicial liquidator.

Third parties (including creditors, but excluding the officers of the debtor and their relatives) may make offers for the acquisition of the entire business of the debtor, or of a substantial part thereof.

A Sale-of-Business Plan is in essence an asset transfer approved by the court. The purchaser is only liable (i) to pay a price as ratified by the court and (ii) to comply with the undertakings as included in the offer and at the court hearing (e.g. commitments in relation to level of employment, level of investments, etc.). As a matter of principle, the purchaser of the business pursuant to a Sale-of-Business Plan is not liable for the liabilities of the debtor. The payment of the price clears all mortgages, charges and other security over the assigned assets, except security in favour of creditor(s) who financed the acquisition of the secured assets. In the latter case, failing agreement with the secured lender, the purchaser of the relevant assets must assume the debt instalments remaining due as from the date of its coming into possession of the assets.

When reviewing a Sale-of-Business Plan the court can decide which contracts are "necessary for the rehabilitation of the business". These contracts are transferred to the assignee of the business notwithstanding any contractual prohibitions. They must be carried out on the terms in force as at the date of the commencement of the proceedings.

Employees whose employment is not continued by the purchaser are made redundant at the expense of the debtor. If necessary, the cost of redundancy is assumed by the insurance system mentioned above.

The creditors are repaid from the proceeds of the sale of the business in accordance with their ranking in the order of priorities prescribed by legislation.

Piecemeal realisation of assets

The piecemeal sale of assets must simply be authorized by the Insolvency Judge, whereas a Sale-of-Business Plan must be decided by the court itself.

Creditor's Rankings

Priorities

Certain salary payments, court fees, and post-judgment debts incurred while the debtor was subject to Rehabilitation Proceedings or debts arising while continuing the business during the observation period are paid in priority to all other debts (whether secured or unsecured).

Unpaid salaries and certain employment-related items originating prior to the opening of the proceedings supersede all other creditors (secured and unsecured), and those originating after the opening of the proceedings have a preferential ranking which may vary upon the type of proceedings instituted.

Generally, the priority of mortgages and other types of security over real estate depend on the date of registration at the land registry. Preferred creditors rank ahead of pledges unless the secured creditors request attribution of ownership of the pledged assets.

Debts arising during the Insolvency Proceedings

Debts incurred by the company after the opening of Insolvency Proceedings relating to the conduct of the proceedings or the commercial activities of the debtor during that period must be paid as they fall due.

If they are not paid as they fall due, they are given preferential status by law and must be paid out of the proceeds of the sale of the debtor's assets, in priority to most other debts.

Challenge to antecedent transactions

In the framework of Rehabilitation Proceedings or Judicial Liquidation (but not in Safeguard Proceedings), the court must fix the date on which it believes the debtor actually became insolvent. This date can be fixed up to 18 months prior to the judgment opening the proceedings.

Certain transactions entered into or payments made between the actual date of insolvency and the judgment opening insolvency proceedings (the "Hardening Period") may be declared null and void. Regarding transactions made for no consideration, the 18 months period is extended for an additional six months.

Certain transactions entered into or payments made during the Hardening Period are automatically voidable by their nature, in particular:

- transaction made without consideration;
- "unbalanced" transactions i.e. in which the obligations of the debtor are notably in excess of those of the other party;
- prepayment;
- payment made otherwise than in a manner commonly accepted in business transactions;
- deposit, or escrow of money without a final court decision;
- security in relation to pre-existing debt;
- attachment or other remedial measure in favour of a creditor; and
- authorisation, exercise or resale of "stock options".

In addition, any payment or agreement entered into or made during the Hardening Period may be nullified by the court if those who dealt with the debtor were aware of its insolvency.

Liabilities and Sanctions

Civil Liability

Civil liability of insolvent individuals under Book VI of French Commercial Code

Insolvent individuals whose creditors have approved a Safeguard Plan or a Rehabilitation Plan can continue to run their business so long as they comply with the terms of the applicable plan. Failure to comply with the plan can result in the rescission of the plan and the opening of a Judicial Liquidation.

Individuals who were subject to Judicial Liquidation are released from all their pre-proceedings debts when the Judicial Liquidation is closed, except as regards:

(i) debts resulting from rights deriving from the creditor's identity, e.g. alimony;

(ii) the obligation to repay guarantors that have paid debts in the debtor's place;

(iii) debts resulting from a judgment establishing that the debtor is guilty of a criminal offence.

In addition, the debtor is not released of any pre-proceedings debts if (i) he has been held guilty of certain of the criminal sanctions described below, or (ii) he (or a legal entity of which he was the director) has already been subject to a Judicial Liquidation which was closed less than five years before the opening of another Judicial Liquidation, or (iii) he committed a fraud against any creditor.

Civil liability of directors of an insolvent legal entity

Persons who are in effect responsible for the running of a legal entity, including "shadow directors", are potentially exposed to liability in the Insolvency Proceedings of that legal entity.

In particular, if a liquidation (either ordered *ab initio* or as a result of the failure of Safeguard Proceedings or of Rehabilitation Proceedings) shows a deficiency of assets against liabilities and the court determines that any shortfall is attributable to management faults and that such faults have contributed to the insolvency of the company, the court may decide that such *de jure* or *de facto* directors/managers/officers shall bear jointly or severally whole or part of the deficiency of assets.

A de facto director/manager is a person (individual or corporate) who performs positive acts of management. *De jure* directors can be held liable even if they did not perform themselves any positive act of mismanagement.

The action may be brought by the judicial liquidator or the public prosecutor. A majority of the creditors appointed as "controller" ("*contrôleur*") are entitled to initiate such a claim if they unsuccessfully requested the judicial liquidator to initiate such claim.

Civil liability of lenders

A lender may be liable in tort for granting or extending credit to a borrower in irredeemable financial difficulties. A lender in this context is anyone who extends credit to the company and includes shareholders (on the basis of shareholder loans), or suppliers (in connection with their trade debt) or any financial institution.

However, the potential liability of lenders who have granted credit facilities within Safeguard Proceedings, Rehabilitation Proceedings or Judicial Liquidation is limited, except in the case of (i) fraud, (ii) interference in management, or (iii) where they received disproportionate security in connection with the credit facilities. If a lender is held liable on the latter grounds, security securing the relevant debt can be nullified or reduced.

The limitation of liability does not seem to apply in the event of "abusive" termination of credit facilities ("*rupture abusive de crédit*") (i.e. termination of credit without prior notice) unless (i) the borrower's behaviour is "seriously reprehensible" or (ii) the borrower is in an "irremediably deteriorated situation".

French criminal law provides that an entity commits the offence of fraudulent bankruptcy if it obtains ruinous means to finance the operations of a business with the intention of avoiding or delaying the opening of Rehabilitation Proceedings or Judicial Liquidation. Lenders that provide such ruinous financing can be held both civilly and criminally liable as accomplices on this basis.

Extension of Insolvency Proceedings to another entity

A court can extend the Insolvency Proceedings of one entity to another entity (either a legal or natural person, which belongs for example to the same group as the insolvent entity) on the following two grounds:

(i) if the assets and liabilities of these entities are commingled ("*confusion des patrimoines*"); or

(ii) if the legal personality of the company is fictitious ("*société fictive*").

As a result of the extension, the two entities will become subject to the same Insolvency Proceedings.

Criminal Liability or Quasi-Criminal Liability

"Faillite personnelle" and prohibition to manage a business

The Court may order the "*faillite personnelle*" of a director (including a *de jure* and a *de facto* director) or an individual for a period of up to 15 years. The order may prohibit such person from managing, directing, administrating, controlling directly or indirectly any enterprise or corporate entity) for the period in which the order is in effect. The court may make such order if such person:

(i) carried out a commercial or other economic activity or worked as a craftsman or undertook the duties of a manager of a corporate entity in breach of any legal prohibition;

(ii) with the intention to avoid or delay the opening of insolvency proceedings, purchased goods in order to resell them below value, or used ruinous means to obtain funds;

(iii) committed the debtor to perform obligations which were unduly onerous on the debtor, when they were entered into, having regard to its situation;

(iv) knowingly paid or caused to be paid, after cessation of payments, a creditor to the prejudice of other creditors;

(v) impeded the good functioning of the insolvency proceedings by deliberately refusing to cooperate with the insolvency organs; and

(vi) disposed of accounting documents, or did not hold accounts whilst obligated to do so under applicable law, or held fictitious, manifestly incomplete or irregular accounts having regards to the applicable provisions.

"*Faillite personnelle*" may also be ordered in the following circumstances against any *de jure* or *de facto* manager of legal entity in Insolvency Proceedings who:

(i) disposed of the assets of the corporate entity as if they were his own;

(ii) under the guise of the corporate entity concealing his acts, carried out acts of commerce for his personal benefit;

(iii) used the assets of the corporate entity in a way contrary to its interests to serve a personal interest or the interests of another company or enterprise in which he had a direct or indirect interest;

(iv) continued abusively, in his personal interest, a loss-making operation which could only lead to cessation of payments of the corporate entity; and

(v) embezzled or concealed the whole or part of the assets, or fraudulently increased the liabilities of the corporate entity.

"*Faillite personnelle*" may also be ordered in the following circumstances against any individual subject to Insolvency Proceedings who:

(i) abusively continued operating a loss-making business that could only lead to his insolvency; or

(ii) embezzled or concealed the whole or part of his assets, or fraudulently increased his liabilities.

Instead of "*faillite personnelle*", the court may make an order prohibiting a person for a period of up to 15 years, from leading, managing, administering, or controlling directly or indirectly a particular enterprise.

Bankruptcy

The criminal offence of bankruptcy ("*banqueroute*") is punishable by imprisonment for a period of up to 5 years and a fine of up to EUR75,000.

A debtor or *de jure* or *de facto* manager of a legal entity in Insolvency Proceedings can be found guilty of bankruptcy in the following circumstances:

(i) with the intention to avoid or delay opening of Rehabilitation Proceedings or Judicial Liquidation, either purchased goods for re-sale below value, or used ruinous means to obtain funds; or

(ii) embezzled or concealed the whole or part of the assets of the debtor;

(iii) fraudulently increased the liabilities of the debtor;

(iv) maintained fictitious accounts, or removed accounting documents, or abstained from maintaining accounts whilst applicable provisions required it to maintain accounts; or

(v) held manifestly incomplete or irregular accounting having regard to applicable legal provisions;

Persons found guilty of bankruptcy may suffer additional penalties including being:

(i) deprived of civic, civil and family rights;

(ii) prohibited from carrying out public duties, or certain professional activities for a period of up to 5 years;

(iii) excluded from public tender offers for a period of up to 5 years;

(iv) prohibited from drawing cheques;

(v) posting or publishing the decision; and

(vi) subjected to "*faillite personnelle*", or being prohibited from managing a corporate entity as described above.

Where the offender is a corporate entity, it may itself be subjected to fines and other penalties including being excluded from public tender offers, and being prohibited from carrying out certain activities.

Other criminal sanctions

The debtor and/or the directors may be prosecuted on other grounds as well. Certain breaches of the stay on creditor action arising on the opening of Insolvency Proceedings, and breaches of the terms of a Safeguard Plan or Rehabilitation Plan are punishable by imprisonment of up to 2 years and/or a fine of EUR30,000, namely:

(i) granting a mortgage or charge over, or disposal of certain assets without obtaining the consents required by law, or payment of debts in whole or in part in breach of the stay on individual claims; or

(ii) payment of a creditor in breach of the terms of discharge of liabilities provided in an approved Rehabilitation or Safeguard Plan, or disposal of assets in breach of such plan.

The beneficiary of the above breaches is liable for the same sanctions as the debtor and directors.

The penalties applicable in case of bankruptcy apply to whoever has removed, received or concealed in whole or in part the assets of the directors (*de jure* or *de facto*) of the company.

The same penalties also apply to those who fraudulently submit claims in Safeguard, Proceedings or Insolvency Proceedings.

The penalties apply also to *de jure* or *de facto* directors of a corporate entity who have embezzled, or concealed, or attempted to embezzle or concealed in whole or in part their assets, or who have fraudulently acknowledged indebtedness for amounts that were not due, in order to avoid the consequences of their liability as a result of insolvency of the company.

Italy

Key Elements:

- Significant legislative reforms 2003–2010
- Amendments to claw-back provisions and the so-called "*concordato preventivo*" (Pre-bankruptcy Creditors' Composition)
- Extraordinary Administration Procedure for the Industrial Restructuring of Large Insolvent Businesses
- Potential civil and criminal liabilities of directors
- "*Esdebitazione*" (release from debts)
- Out of court reorganization plan under Article 67, paragraph 3 (d) of the Bankruptcy Act and Debt Restructuring Arrangements under article 182 bis of the Bankruptcy Act
- Priority for rescue finance
- Relief from equitable subordination
- Exemptions from liability for lenders in respect of criminal sanctions

Introduction

Under Italian law a company can be wound up either through a liquidation procedure, applicable when the company is solvent, or through a "*procedura concorsuale*" (procedure affecting creditors' rights generally), applicable when the company is insolvent.

The statutory framework for insolvency-related procedures is primarily set out in Royal Decree no. 267 of 16 March 1942 (the "Bankruptcy Act"), as amended by law no. 80 of 2005 and Legislative Decree no. 5 of 2006 (as further amended by Legislative Decree no. 169/2007) and recently amended by Legislative Decree no. 78 dated 31 May 2010, in Legislative Decree no. 270 of 1999 ("the Law on Extraordinary Administration") and by law no. 39 of 23 December 2003 ("Urgent Measures for the Industrial Restructuring of Large Insolvent Businesses", the so-called "Marzano Decree").

The first amendments to the Italian Bankruptcy Act are in force as of 17 March 2005.

In light of the above, (i) the new claw-back regime is applicable to any claw-back action enforced within any bankruptcy proceedings which are commenced after 17 March 2005; and

(ii) the provisions relating to the Pre-Bankruptcy Creditors' Composition are applicable to any pending and unapproved pre-bankruptcy creditors' composition from 17 March 2005.

The rules reformed by Legislative Decree no. 5 of 2006 are applicable to all the bankruptcy proceedings which began after 16 July 2006 while the previous law is still applicable to cases commenced before that date.

The rules reformed by the corrective Legislative Decree no. 169/2007 are applicable to all the outstanding bankruptcy proceedings at the time it came into force and to those which were commenced after 1 January 2008.

Finally, the rules reformed by the Legislative Decree no. 78 dated 31 May 2010 are applicable to any proceedings commenced after 31 July 2010.

Most Important Reforms

The changes to the principles of the Italian Bankruptcy Procedure have been carried out in different phases; the first step was taken in 2004 when the decree "Urgent Measures for the Industrial Restructuring of Large Insolvent Businesses" was enacted. It was aimed at the financial restructuring of large insolvent companies meeting specific requirements as to the number of employees and the amount of their debts: its purpose is therefore to allow such companies to continue their operations and return to a sound financial position on the basis of a 2 year restructuring plan. Secondly, in 2005, the Bankruptcy Act was partially amended by the reforms relating to claw-back action, the pre-bankruptcy creditors' composition and the introduction of the Debt Restructuring Arrangements.

Finally, 2006 saw the almost total reform of the Bankruptcy Act (except the aspects that contain criminal sanctions[1]) fully completed by the Legislative Decree 169/2007. After the reforms, the Italian Bankruptcy Act focuses to a greater extent on allowing companies to continue their operations and, consequently, protecting investments in Italy. This decision by the Italian legislators is aimed at reviving the Italian economy which has been beset by considerable difficulties in the last few years.

The most recent reforms included in the Legislative Decree No 78 dated 31 May 2010 focuses on business rescue. The reforms include: a new legal priority for rescue finance; partial relief from equitable subordination; exemptions from liability for lenders in certain circumstances; and an extension to the moratorium which is now available in the restructuring negotiations stage.

It will take some years to be able to assess the impact of this reform on the Italian economy.

The principal aim of the reforms is to allow companies to continue their operations

[1] Please note a reform of the criminal bankruptcy sanction is under study by an ad hoc parliamentary commission.

and many changes have been made to such an end, for example:

- increasing the number of entities excluded from bankruptcy proceedings;
- changing and widening the powers of the bankruptcy receiver;
- extending the powers of the committee of creditors.

In addition, the position of the debtor has been improved by the:

- abolition of the public register of debtors declared bankrupt;
- introduction of the so-called "*esdebitazione*".

Great changes have also been made with regard to:

- the provisions relating to claw-back action;
- the pre-bankruptcy creditors' composition.

Winding up Procedures

Liquidation voluntary and mandatory

The liquidation procedure is governed by company law. The decision to put a company into voluntary liquidation must be taken by shareholders. A liquidator is appointed at the shareholders' meeting to sell the assets, pay off creditors and prepare a final liquidation balance sheet and report. Shareholders may object to the balance sheet within ninety days. If no objection is raised, approval is deemed to have been given and the liquidator can distribute any proceeds to shareholders. Ultimately, the company is struck off the companies' register.

Companies are subject to mandatory liquidation when their equity capital is reduced below the legal minimum, and also (at least in principle, although in practice this very rarely occurs) when the object for which the company was formed is attained or for any other reason set out in the by-laws.

Bankruptcy proceedings (fallimento)

This court-supervised procedure is governed by the Bankruptcy Act. After the recent reform, the Bankruptcy Act applies to all entities that carry on a commercial activity, except public bodies. The recent reform (Legislative Decree 169/2007) has introduced a number of criteria to identify the entities and the businesses (including individuals) that cannot be declared bankrupt. The entities and the entrepreneurs that can be declared bankrupt are the ones that:

- have reached in the last three years (from the bankruptcy petition or from its incorporation) an annual balance sheet revenue higher than €300,000;
- have reached in the last three years (from the bankruptcy petition or its incorporation) an annual gross proceeds higher than €200,000;
- have debts (including debts not yet due) for an amount higher than €500,000.

The companies and the entrepreneurs that want to avoid being declared bankrupt must demonstrate that they have not exceeded all the three above-mentioned requirements.

A receiver is appointed who will usually, but not necessarily, be a lawyer or a certified accountant. Following the recent reforms, the receiver may also be a law firm as long as there is no conflict of interest. The main goal of the Bankruptcy Procedure (and therefore of the receiver) is to liquidate the assets of the company in order to satisfy the creditors.

Bankruptcy Administration

The reforms have modified the roles and duties of the administrative bodies that operate in a bankruptcy. First of all, following the reforms, the bankruptcy judge no longer has any managerial powers, but only supervisory and control functions. These supervisory functions have been improved in order to avoid uncontrolled management by the receiver. The receiver on the other hand now has more duties: he administers the debtor's assets and is responsible for the procedure. He must produce a report on the causes of the insolvency to the judge within sixty days of the bankruptcy declaration. The role of the committee of creditors has been greatly modified by the reforms and now possesses powers of authorisation and control over the receiver in addition to its advisory functions.

Once the procedure has commenced, no individual actions by any creditor are allowed. The company's directors lose the right to manage the business or deal with the corporate assets. Continuation of operations may, however, be authorised by the court if an interruption would cause greater damage to the company, but only if the continuation of the company's operations does not cause damage to creditors. After the reform, it is possible to lease the business or a part of it, the lessee, chosen by the receiver, decides upon the best solution in order to prevent the dispersion of company assets, workers and their professional skills. The aim of the company lessor is to save and restructure the company.

The transactions pending as of the date of the bankruptcy declaration are suspended until the receiver decides whether to take them over, this is unless the ruling on the declaration of bankruptcy allows the company to continue its operations on a provisional basis. The possibility of allowing the company's operations to continue, as regulated by the new article 104 of the Bankruptcy Act, is one of the most important reform measures aimed at avoiding the dispersal of the insolvent company's assets and protecting creditors.

If the bankruptcy of the company does not allow it to continue its operations, then the loans intended for a specific activity (introduced into the Italian legal system by the recent reform of the Company Law) are terminated. The continuation of such funding is instrumental in the continuation of the company's operations. The receiver shall provide, pursuant to article 107, for the transfer to third parties of the assets in order to allow the company to continue operations. The receiver can decide to delegate the judge to sell movable, immovable and registered movable. If transfer is not possible, the receiver will provide for the liquidation of the assets in accordance with the liquidation rules of the company to the extent compatible with the procedure.

As regards to the liquidation phase, according to the reformed article 105, individual assets of the company may be sold but only when the sale of the whole company or part of it does not satisfy creditors in a more advantageous manner.

The bankruptcy proceedings end when:

(i) all the assets have been distributed amongst the company's creditors or all debts and expenses have been paid; or

(ii) a post-bankruptcy composition has been finalised (see below); or

(iii) in the fixed term, after the bankruptcy declaration no creditors have filed a claim; or

(iv) all creditors have been paid in full; or

(v) the company's assets have been liquidated but they are insufficient to satisfy all or a part of outstanding claims.

In (iv) and (v) if the bankrupt entity is a company, it is removed from the Companies Register. In the past, bankruptcy proceedings could last for up to five or more years but following the reforms, the procedure will probably be quicker.

Post-Bankruptcy Creditors' Composition*

This procedure is an alternative way of bringing the bankruptcy proceedings to an end. One or more creditors or a third party are authorised to propose the composition but it cannot be proposed by the debtor or by a company in which it holds a stake or companies subject to the same control if less than six months have passed since the insolvency declaration or if less than one year has passed since the order enforcing the insolvency. The proposal for post-bankruptcy composition with creditors can include (article 124 of the Bankruptcy Act):

- the subdivision of creditors into different classes;
- different treatments of different kinds of creditors;
- the restructuring of debts and the satisfaction of claims in any way, including through the supply of goods, takeover (Accollo) or other extraordinary transactions.

The proposal may provide that the creditors that hold a preference, a pledge or a mortgage are not satisfied in full on the condition that the plan provides for their satisfaction in an amount not lower than the best possible price which may be obtained from the winding-up taking into consideration the market value of the goods or rights on which there is the preference as estimated by a qualified consultant. The treatment established for each class of creditors may not have the effect of changing the ranking of the preferential claims as laid down by the law.

In cases where more than one proposal are submitted to the court, the creditors' committee is entitled to decide which proposal would be communicated to the creditors; upon request of the receiver the judge may communicate to the creditors the proposal which the receiver considers convenient at the same level of the one chosen by the creditors' committee.

This procedure must be approved by the creditors that represent the majority of the claims admitted to the vote. In the absence of any objections a creditor's consent to the composition is deemed to have been given.

Bankruptcy of Companies

According to article 146 of the Bankruptcy Act, the directors and liquidators of companies must observe the obligation imposed upon the debtor. The receiver can bring actions for liability against directors, statutory auditors, general managers and liquidators.

The judgment which declares a company insolvent will also involve the members of the company who have unlimited liability, (article 147 of the Bankruptcy Act). Unlimited liability members cannot be declared bankrupt if a year has passed since the end of the relationship or since the end of the unlimited liability.

The summary procedure (governed by articles 155-156 of the Bankruptcy Act) has been eliminated and this abrogation is due to the streamlining of procedures provided for by the Bankruptcy Act. The new articles 155-156 regulate the assets intended for a specific activity (article 2447 bis of the Italian Civil Code). The receiver can transfer them to third parties in order to preserve their initially intended use or he can liquidate them. The proceeds from the liquidation will be part of the assets.

The Extraordinary Administration Procedure and the Marzano Procedure for the Industrial Restructuring of Large Insolvent Businesses

The Legislative Decree 270/1999 regulated the "Extraordinary

* Please note that the post bankruptcy creditors' composition has been recently amended by the Law n. 69/09.

Administration for Large Insolvent Businesses" ("Extraordinary Administration Procedure") that is a sort of insolvency procedure for large businesses.

The Extraordinary Administration Procedure is applicable to large businesses in a state of insolvency when there is the expectation that the company's situation may be rebalanced either through (a) the sale of its assets, undertakings or going-concerns (provided that the duration of the relevant programme cannot exceed 1 year); or (b) the execution of a restructuring programme, the duration of which cannot exceed 2 years.

The Extraordinary Administration Procedure applies to companies meeting the following cumulative criteria:

- more than 200 employees during the preceding 12 months; and
- aggregate debts no lower than two thirds of each of (i) the assets on the company's balance sheet and (ii) the incomes deriving from the sales made and the services provided during the latest accounting period.

Whilst the admission to the Marzano Procedure usually precedes the declaration of insolvency, the Extraordinary Administration Procedure requires the petition for the insolvency declaration to be filed before the competent Court, which may be then followed, according to the steps set out below, by admission to the Extraordinary Administration Procedure.

A petition for the insolvency declaration and the successive admission to the Extraordinary Administration Procedure may be filed by the company, its creditors, the public prosecutor (*pubblico ministero*) or ex officio by the Bankruptcy Court.

In the judgment declaring the state of insolvency, the Court, inter alia appoints one to three judicial commissioner(s) for the management of the company from the date on which it is declared insolvent until the appointment of the extraordinary commissioner(s), after the company has been admitted to the Extraordinary Administration Procedure: within 30 days from the declaration of insolvency, such judicial commissioner(s) must file before the Bankruptcy Court a report describing the reasons leading to the insolvency of the company and a reasoned evaluation of the existence of the conditions set forth by law for the admission of the company to the Extraordinary Administration Procedure. A copy of such report is sent to the Minister of Economic Development.

From the date of the report, the Bankruptcy Court has an additional delay of 30 days to resolve on the opening of the Extraordinary Administration Procedure, to which the company is admitted if there is a concrete expectation that its financial situation can be rebalanced upon one of the possible alternative mentioned above at letter (a) and (b): where this is not the case, the Bankruptcy Court declares the company insolvent and the Bankruptcy Procedure will apply.

Within 5 days from the decree of the Bankruptcy Court declaring the opening of the Extraordinary Administration Procedure, the Minister of Economic Development appoints one to three extraordinary commissioner(s) which, within the following 55 days must deliver to the Minister of Economic Development the recovery plan of the company. Such term can be postponed for a further period of 60 days.

Within 30 days from the date of its delivery, the Minister of Economic Development authorises the recovery plan, which must also contain an indication of the method and timing of repayment of outstanding debts. Once approved, the plan must be carried out by the extraordinary commissioner(s) under the supervision of the Minister of Economic Development.

Assets can be sold according to the plan on a going-concern basis or sold individually. The distribution of the realisation proceeds will be generally carried out in the order of priority provided for in the Bankruptcy Act. However, there may be cases where, should the continuation of the business so require, the extraordinary commissioner is entitled to make advance payments to unsecured creditors in preference to secured creditors on the basis of the estimated available funds.

If its goals have been achieved and the company, after the implementation of the plan, has returned to a sound financial condition and has repaid outstanding debts, the Court will terminate the proceeding and the company may return to its normal corporate activity.

If the above-mentioned requirements are not met, and in any other moment in which, upon admission thereto, the Extraordinary Administration Procedure may not be usefully continued, the Bankruptcy Court may declare the company bankrupt.

On 23 December 2003, the Italian government approved the Decree "Urgent Measures For The Industrial Restructuring of Large Insolvent Businesses" (the so-called "Marzano Decree"), which came into force on 24 December 2003 when it was published in the Italian Official Gazette.

The Marzano Decree introduces a faster procedure which aims to save and turn around an insolvent company in order to maintain its technical, commercial, productive and employment value. The purpose is mainly the continuation of the company's operations by restructuring the company's debts and selling assets which are not strategic or which do not form part of the company's core business.

The above mentioned extraordinary administration procedure is available to large insolvent businesses which have:

(a) actual prospects of recovery, through the economic and financial restructuring of the business on the basis of a restructuring plan whose duration cannot be more than 2 years or through a transfer of the company's assets;

(b) a minimum of 500 employees for at least one year; and

(c) debts, as well as obligations arising from guarantees, for an aggregate amount not lower than €300,000,000.

A company which meets the requirements set out above may request the Minister of Production ("*Ministro delle Attivit Produttive*", formerly the Minister of Industry), with a concurrent application of insolvency to the competent court, for admission to the Marzano Procedure. The admission to the Marzano Procedure may be requested even before the declaration of insolvency by the competent court. In this case the competent court will verify the insolvency of the company at a later stage. Further to the request of admission, the Minister of Production, who is the procedure's supervisor, will designate by decree an extraordinary commissioner setting out his/her specific powers. Such decree must be notified to the competent court within 3 days.

With reference to the companies which provide essential public services, pursuant to the amendments introduced by the Law Decree no.134/2008, the admission to the Marzano procedure, the appointment of the Extraordinary Commissioner (and the determination of his powers) must be approved by the President of the Council of Ministers or by the Minister of Economic Development (*Ministro dello Sviluppo Economico*).

Once the company has been admitted to the procedure, no individual action may be brought by any creditor.

The extraordinary commissioner is in charge of running the company and managing its assets. He/she also carries out the duties entrusted to the preliminary commissioner (*commissario giudiziale*) under the Law on Extraordinary Administration. In particular, the extraordinary commissioner must notify the creditors of the company, and the parties who have security over assets in the possession of the company, of the deadline by which the company's creditors must file their statements of claim with the competent court.

Within 60 days from his/her appointment, the extraordinary commissioner files a report with the competent court together with the following documents: (i) accounting records, (ii) the balance sheets from the last 2 fiscal years, (iii) an updated financial statement, (iv) the list of the company's creditors and the sums due to them, (v) list of parties who have security over assets. The term of 60 days may be extended by the court upon request of the commissioner only once and for a period not longer than 60 days.

Within the above term, the commissioner may present to the Minister of Production the admission request of other companies of the group to the New Extraordinary Administration.

After ascertaining that the company is insolvent, the court will:

(a) appoint a judge in charge of the procedure (so-called "*giudice delegato*");

(b) invite the creditors of the company and the parties who have security over global change to "assets" to file their statement of the claims; and

(c) establish the date on which the hearing for the examination of the debts of the company will take place.

The extraordinary commissioner will submit, within 180 days from his/her appointment, the restructuring plan and a report including (i) the reasons which caused the insolvency, (ii) the status of the business, and (iii) the list of creditors, with the sums due to them and their priority rights, to the Minister of Production. The term of 180 days may be extended for a further 90 days.

If the Minister of Production does not authorise the implementation of the restructuring plan and there is no possibility to rescue the company through the sale of developing businesses according to the plan for the continuation of the company's operations (whose duration shall not be longer than one year), the court will declare the company bankrupt. The decree no.134/2008 introduced also an extension of the deadline for up to 12 months. Thus the Extraordinary Commissioner may obtain an extension of the deadlines for the implementation of the plan.

Within 15 days from the appointment of the extraordinary commissioner, the Minister of Production designates a delegated committee, composed of either 3 or 5 members, one or two of which (subject to the number of the members) is chosen from amongst the unsecured creditors. In practice, it appears that the 15 days term may be extended. The remaining members are experts in the type of business carried out by the insolvent company or experts in the insolvency field. The Minister of Production elects a chairman from the members of the delegated committee.

The delegated committee is a consulting body, whose comments and opinions are not binding. The committee issues comments/opinions on the actions of the extraordinary commissioner.

In addition to these powers, the delegated committee may:

(a) inspect, at any time, any financial document relating to the procedure and ask the extraordinary commissioner and the insolvent company for elucidations;

(b) request the Minister of Production to dismiss the extraordinary commissioner.

After being requested, the delegated committee issues its comments/opinions within 10 days, except when it is invited to respond earlier, for reasons of urgency. In any event, the delegated committee should be granted at least 3 days to submit its response. Its resolutions are passed by a majority vote of its members.

The extraordinary commissioner's restructuring plan may include an arrangement with creditors (the so-called "*concordato*").

The satisfaction of the creditors' claims by means of an arrangement can provide for the repayment of debts in any form, such as a debt to equity swap, or the allocation of ordinary or convertible debt securities. The arrangement can also provide for the incorporation of a NewCo to which the insolvent company will transfer all its assets and the shares of which will be distributed to the creditors of the debtor company in the context of a debt to equity swap. The distribution of shares in the NewCo to the creditors is achieved through a vehicle (so-called "*Assuntore*") to which the creditors have conferred all their claims against the insolvent company. The Assuntore confers the claims to the NewCo as an equity contribution and receives shares into the NewCo, which it distributes to the creditors in accordance with the terms of the arrangement.

The arrangement can formulate separate classes of creditors whose legal and financial interest is aligned (i.e. individual investors; bondholders, etc.) and provide for a different treatment by class. A different treatment can also be provided for creditors of different corporate entities within the insolvent group. In the event the arrangement provides for a separate treatment, its fairness is subject to the government's scrutiny and must be approved by the Minister.

Once the Minister has approved the proposed arrangement, the extraordinary commissioner files the arrangement with the court, together with a motion to proceed by way of arrangement; in the next ten days the creditors can file their comments on the proposed list of creditors, the proposed list of claims and relevant amounts and ranking. Within the same time, the creditors excluded from the arrangement can file their claim with the court.

Within the following sixty days, the judge, assisted by the extraordinary commissioner, announces a provisional list of creditors and claims with the relevant amounts and ranking and the extraordinary commissioner notifies the creditors. The creditors in the provisional list are admitted to vote on the arrangement. The holders of securities that have been distributed to the public can be admitted as a class and there is no need to identify each security holder.

Those creditors excluded from the provisional list can appeal the relevant order issued by the court. Pending the appeal they are allowed to vote on the arrangement and will participate in the allocation of shares in the NewCo. However, the bankruptcy judge may order that any shares issued to such excluded creditors are restricted. In that case the shareholder cannot sell those shares until the court has reached a decision on the appeal.

The arrangement will be finally approved by a vote of creditors representing the majority in the value of claims admitted to the provisional list. Voting takes place by post. A non-vote is considered to be a consent to the arrangement. In case of several classes of creditors, the arrangement must be approved by creditors representing a majority in the value of claims admitted to the provisional list for each class. However, even if the arrangement is not approved by a majority of the classes of creditors, the court can still authorise the arrangement if it considers that in comparison with the alternatives, it does not prejudice the dissenting creditors.

If the required majority vote is reached, the court issues a judgment approving the arrangement; if such majority is not reached, the extraordinary commissioner must file all the necessary amendments for the arrangement to be approved. The judgment by means of which the arrangement is approved can also provide for the transfer of all the assets of the insolvency company to the NewCo (*Assuntore*) formed for the purpose of implementing the arrangement.

The judgment approving the arrangement is enforceable against all creditors whose claims arise prior to the judicial declaration of insolvency and can be appealed by the company, by the creditors and by the extraordinary commissioner within 15 days of being published. If the appeal is successful, the list of creditors and claims is amended accordingly, though such amendment will not affect the vote on the arrangement.

Once the judgment approving the arrangement is *res judicata*, the proceeding comes to an end.

In case the creditors reject the arrangement, the extraordinary administrator can file with the Ministry a divestiture plan which can be extended to a period of time as long as two years. If a divestiture plan is not promptly filed or the Ministry does not approve it, the court will issue an order to convert the extraordinary administration into an ordinary bankruptcy proceeding.

Upon the request of the extraordinary commissioner, the Minister of Production may authorise the transfer, use and lease of assets, real estate, businesses and ongoing concerns of the company with the aim of restructuring the company or its group.

The company may not grant security unless (i) it has been authorised by the bankruptcy judge; and (ii) it has also been authorised by the Minister of Production, if the security is for an undetermined value or for a value exceeding €206,582.76.

When authorisation for the implementation of the restructuring plan has been granted, the extraordinary commissioner may also bring claw-back actions, if such actions benefit the creditors.

The procedure ends when its goals have been achieved, i.e. when the company, after the implementation of the plan, is back in a sound financial position. Otherwise, the company will be declared insolvent pursuant to the Italian Bankruptcy Act.

(Please note that the extraordinary administration procedure has been recently amended by the Legislative decree n. 70/2011.)

Compulsory Administrative Liquidation

This procedure is only available to public undertakings, insurance companies, banks and certain other regulated entities. The entities which can be subject to this procedure are specifically indicated by the law and generally they cannot be declared bankrupt.

Rescue Procedures

Prebankruptcy creditors' composition

The amendments to the Italian Bankruptcy Act have widened the access to the "*Concordato Preventivo*" (Pre-Bankruptcy Creditors' Composition) by eliminating:

(a) subjective requirements (insolvency status of the debtor; the registration in the companies' register for at least two years; no declaration of Bankruptcy in the previous five years); and

(b) objective requirements (grant of guarantee or security in order to secure the payment of at least 40% of the unsecured creditors) that were required under the Bankruptcy Act.

The amendments to the Italian Bankruptcy Act have also reduced the creditors' majority required to approve a Pre-Bankruptcy Creditors' Composition.

Under the new article 160 of the Bankruptcy Act the proposal may provide that the creditors that have a priority right, a pledge or a mortgage are not satisfied in full, on the condition that, the plan provides for their satisfaction in an amount not lower than the best possible price which could be obtained in a winding-up taking into consideration the market value of the goods or rights on which there is the priority as estimated by a qualified valuer.

The Public Prosecutor must be informed that a Pre-Bankruptcy Creditors' Composition petition has been filed.

Under the new article 177 of the Bankruptcy Act, the Pre-Bankruptcy Creditors' Composition petition must be upheld by the majority of the voting creditors. To the extent that the creditors are divided in different classes, the Pre-Bankruptcy Creditors' Composition petition must be upheld by the majority of the classes of the voting creditors. The creditors that have a priority claim, a pledge or a mortgage for which the Pre-Bankruptcy Composition petition provides for their full satisfaction do not have to right to vote if they do not give up their priority/security.

Debt restructuring arrangements under article 182bis of the Bankruptcy Act

The Amendments to the Italian Bankruptcy Act have introduced the so-called "*Accordi di Ristrutturazione dei Debiti*" (Debt Restructuring Arrangements), whereby an entity can enter into a composition with creditors (which is binding on all the creditors of such entity) provided that:

(a) the Debt Restructuring Arrangement is agreed by creditors representing at least 60% of its debts;

(b) the feasibility of the Debt Restructuring Arrangements and the suitability of such arrangements to ensure repayment of those creditors who did not agree with such Arrangements is confirmed by an independent expert (who must have the requirements provided by article 67(d) of the Bankruptcy Act); and

(c) after the filing of the restructuring agreement there is a 60 day stay. In the recent reforms changes were made to the provision according to which the stay on enforcement and precautionary measures may be extended to the negotiations phase for the period of sixty days preceding the filing of the restructuring arrangements. The Legislative Decree no. 78, further specifies that the Court will also prohibit the granting of new security, unless these have been agreed.

Within 30 days from the issue of the Debt Restructuring Arrangement the creditors and any other interested person can challenge it. The Court, after deciding on the challenges, homologates the Debt Restructuring Arrangement with a decree.

Pursuant to article 182 ter as modified by Legislative Decree 196/2007 and by Legislative Decree n. 78/2010, it is possible to file a fiscal arrangement not only together with a of a Pre-Bankruptcy Composition with creditors but also together with a Debt Restructuring Arrangement. The fiscal arrangement enables the debtor to pay his fiscal debts partially and periodically.

Furthermore pursuant to article 182 ter as introduced by Legislative Decree n. 78/2010 (became effective only on 31 July 2010), a set of "stability" measures have been adopted by the Italian Government, including a number of significant provisions in the context of rescue procedures as follows:

(a) super senior financing: provisions have been introduced which allow lenders that provide rescue or interim financing to a distressed company in Italy to acquire priority over the existing creditors of the company, but only to the extent the financing is provided in the context of either:

  (i) a debt restructuring arrangement under Article 182 *bis*; or

  (ii) a Prebankruptcy creditors' composition.

(b) equitisation risk: the rules on equitable subordination[2] have been dis-applied in the case of shareholders' loans granted in the context of the above mentioned restructuring procedures but only up to an amount equal to 80% of the amount of the relevant shareholders' loan(s);

Out of court reorganization plans (Piani di risanamento) under Article 67, Paragraph 3(d) of the Bankruptcy Act.

The Amendments to the Italian Bankruptcy Act have also introduced the so-called "*piani di risanamento*" whereby a distressed company may restructure its indebtedness and ensure the recovery, by proposing a reorganization plan to all or some of its creditors.

The terms and conditions of these plans are freely negotiable and usually provide for a moratorium, cram down of claims, debt refinancing and an undertaking to refrain from requesting the commencement of any insolvency proceedings of the debtor.

Neither ratification by the court nor publication in the Companies' Register are needed. The only requisite prescribed by the law is that the reasonableness of the plan must be assessed by an independent expert.

Unlike pre-bankruptcy creditors' composition and debt restructuring arrangements, out-of-court reorganization plans do not offer the debtor any general protection against enforcement proceedings and/or precautionary measures initiated by third-party creditors. The Bankruptcy Act provides that, should these plans fail and the debtor be declared bankrupt, the payments and/or acts carried out for the implementation of the reorganization plan are not subject to claw-back action provided that the feasibility of the plan has been confirmed by a report drafted by an independent expert.

Other Issues
Directors' Responsibilities

Duties imposed on directors apply equally to those who, although not formally appointed to office, carry out managerial activities or are involved in the running of the company.

Civil liability

Directors are jointly and severally liable for breach of their duties. However, a director must be blameworthy to share in this liability. Liability between the directors is divided according to the degree of fault and the damage caused; but where a director can establish his/her lack of blame for the breach, he/she will not be liable at all.

A claim may be brought against a director by the company, by a shareholder or by a creditor who has suffered a loss as a consequence of the director(s)' misbehaviour. If the company is bankrupt or subject to any analogous procedure, the claim may be brought by the receiver.

Where a director has committed an act or omission against the provisions of law or those of the articles of association (e.g. has failed to act with normal diligence in supervising the conduct of the company's affairs, or has failed to do his/her best to prevent the occurrence of prejudicial acts or reduce their harmful effects, or has acted with a conflict of interest), and the company suffers damage as an immediate and direct consequence, directors are personally and jointly liable to the company for the damage suffered. Directors must therefore be wary of simply resigning from a company in financial distress, as this will not be sufficient to discharge their duties.

Directors are liable to the company's creditors for non-observance of their duties concerning the preservation of the company's assets which results in loss to creditors. Shareholders or third parties who suffer damage which directly affects their interests as a result of a director's malicious or intentional act may be entitled to compensation.

Directors are under a duty to call a meeting without delay in the event that the equity capital has decreased 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. An

[2] Articles 2497 and 2467 of the Italian Civil Code contemplates that shareholders'/intercompany loans granted to an "undercapitalised" company within the same group may be subordinated by operation of law to all other debts of such company, if granted at a time when, taking into consideration also the business carried out by the company: (i) the company's indebtedness was excessively high compared to shareholders' equity, or (ii) the company's financial situation was such that a shareholders' contribution would have been reasonable under the circumstances.

alternative way to prosecute in this situation is to prove liability for negligent mismanagement in not having acted to prevent losses.

Directors may also be liable for violations which create an over or under valuation of company assets; for falsifying accounts; for failing to make necessary provision for the payment of taxes which causes the liquidation of the company; or failing to make social security payments to employees.

The courts have applied the civil liability regime to de facto directors of a company, on the basis of a test of actual management of, or intervention in the management of, a company by a person who was not formally empowered to act as a director. Thus, in the event that a bank representative was found to have caused damage to a company acting as a de facto director of the same, the bank representative may be held liable to pay damages to the company.

Criminal liabilities

A director of company may be held criminally liable in respect of actions over the company's assets taken prior the bankruptcy of the company. The most important of these are where a company has:

(a) misused assets in order to prejudice its creditors - article 216 of the Bankruptcy Act;

(b) taken imprudent actions to delay the declaration of bankruptcy - article 217 of the Bankruptcy Act; and

(c) disguised its financial distress or its insolvency state in order to obtain financing (unlawful recourse to lending) - article 218 of the Bankruptcy Act.

The administrators and the liquidators of a company are also subject to these potential liabilities.

The Law Decree no.78/2010 introduced exemptions from criminal liability in relation to lenders providing finance to distressed businesses, as long as the finance is provided in the context of a formal restructuring. In particular, the legislative changes provided certain exemptions from criminal liability in relation to the conduct described above under (a) (made for the purpose of preferring certain creditors to the detriment of other creditors) and (b) when carried out in the context of either debt restructuring arrangements under Article 182 *bis*, a Prebankruptcy creditors' composition, or out of court reorganization plans under Article 67(3)(d).

Claw-back

Any act of a company, which is subsequently declared bankrupt (including any payments and the granting of security), may be clawed back by the court at the request of the receiver if carried out during a "risk period". The amendments to the Italian Bankruptcy Act have halved all of the claw-back periods, such claw-back periods now amount to:

(a) 1 year, with respect to transactions at an undervalue, or involving unusual means of payment (e.g. payment in kind) or security taken after the creation of the secured obligations, whereby the creditor must prove his lack of knowledge of the state of insolvency of the relevant entity in order to rebut any claw-back action;

(b) 6 months with respect to security granted in order to secure a debt due and payable, whereby the creditor must prove his lack of knowledge of the state of insolvency of the relevant entity in order to rebut any claw-back action; and

(c) 6 months with respect to payments of due and payable obligations, transactions at arm's length or security taken simultaneously to the creation of the secured obligations, whereby the receiver must prove that the creditor was aware of the state of insolvency of the relevant entity in order to enforce any claw-back action.

It is important to underline the difference between situations provided by (a) and

(b) above, that, in order to rebut any claw-back actions, the third party must demonstrate that he did not know that the debtor was insolvent whereas in

(c) it is the receiver that must prove that the other party knew the debtor was insolvent.

Furthermore, with regard to paragraph (a) above, the amendments to the Italian Bankruptcy Act, expressly set out when a transaction is deemed to be at undervalue, i.e. when the asset or obligation given or undertaken exceeds by one quarter the value of the consideration received by the debtor. The amendments to the Italian Bankruptcy Act have, therefore, incorporated the "one quarter principle" established by the Italian case law in order to limit any discretion of the receiver or the courts.

The amendments to the Italian Bankruptcy Law have also established several exemptions to the application of the claw-back regime.

Under the new regime, a claw-back action cannot be filed in relation to:

(a) payments made for assets and services within the ordinary course of business;

(b) payments made into a bank current account, provided that such payments have not considerably reduced over a period of time the indebtedness of the bankrupt vis-à-vis the account holding bank;

(c) the sale of real estate for residential purposes at arms length, to the extent that such real estate is used as a main house by the buyer or his/her relatives and relatives-in-law;

(d) transactions involving payments as well as security taken over the assets of the debtor, provided that such payments were made or security was taken in order to implement a plan which is deemed "suitable" to redress the indebtedness of the debtor and to readjust its financial situation;

(e) transactions involving payments as well as security taken over the assets of the debtor, provided that such payments were made or security was taken so as to implement a Pre-bankruptcy Creditors' Composition, Controlled Management or the Debt Restructuring Arrangements (see paragraphs above);

(f) payments of the amounts due for the services carried out by the employees and the independent contractors of the debtor entity; and

(g) payments of due and payable obligations in order to obtain services which are auxiliary to the access to the Controlled.

As evidenced above, the exemption contemplated under (d) is of particular interest. The reference to the expert's report must be interpreted as a report assessing the reasonableness of the plan which is deemed "suitable" to redress the indebtedness of the debtor and to readjust its financial situation, e.g. in case of a refinancing plan (where there is no leveraged merger buy-out), the said report must assess the reasonableness of the plan as far as the reimbursement of the refinancing is concerned.

Esdebitazione

An important measure introduced by the reform is the discharge of some debts in the case of good conduct. This privilege is available only if the debtor is an individual and where some of the creditors have not been satisfied.

The debtor may benefit from this procedure if:

- he has cooperated with the administrative bodies in the proceedings;
- he has not caused delay in the proceedings;
- he has complied with the order to provide the receiver with the correspondence concerning the relationships involved in the bankruptcy;
- he has benefited from the same procedure in the last ten years;
- he has not committed criminal offences such as the misappropriation of assets in order to prejudice creditors or the reporting of non-existent liabilities; causing or worsening the insolvency in order to make difficult the reconstruction of the assets and business, unlawful financing;
- he has not been convicted of fraudulent bankruptcy or offences against the economy, industry or commerce if there has been no rehabilitation for these crimes.

Security

Taking a security interest over an asset does not involve a transfer in ownership. Transferring an asset for the purposes of creating something analogous to a security interest is generally forbidden by law and any agreement to such an end is, in principle, null and void.

Security cannot be taken over leasehold interests, and floating charges are not possible (although a "*privilegio speciale*" - a special type of pledge not requiring delivery - may be analogous in some respects). The concept of a trust is not fully recognised by Italian law.

Security usually ranks in order of creation. Where registration is required, security will rank in order of registration.

Certain creditors, e.g. tax and social security authorities are preferred by operation of law.

Enforcement of Security - in general and in relation to Bankruptcy

Other than in respect of pledges (where the parties can agree on specific procedures for enforcement), enforcement of security is normally a court-supervised procedure, and is lengthy and bureaucratic.

The enforcement of a mortgage can only be requested on the basis of an enforceable right for a definite, liquidated and matured amount. Enforceable rights include enforceable judgments, bills of exchange and other credit instruments. Notice of the right to enforce must be served on the debtor together with the warning to fulfil its obligation within a term not shorter than ten days. Thereafter the creditor may request the sale of the charged asset. This sale is normally carried out by the court or a notary in accordance with the Italian Code of Civil Procedure.

Pledges can be enforced during bankruptcy proceedings provided that the secured creditor has filed its statement of claim with the court and the court has ascertained its secured creditor status. Thereafter, the secured creditor must request the authorisation of the judge in charge of the bankruptcy, who will establish the manner and timing of the sale. The judge may also authorise the official receiver to keep the pledged assets and to pay the secured creditors.

Security over real estate cannot be enforced independently of the general liquidation of the assets. The sale of the relevant real estate is made by the receiver, although the secured creditor has a priority right over the proceeds from the sale.

Guarantees

Guarantees are available in most circumstances. However, corporate benefit must be established if a company is granting a guarantee. This may take two different forms:

(a) the act must not be ultra vires, i.e. must be within the objects of the company as stated in the by-laws; and

(b) any director and any shareholder having an interest in conflict with the interest of the company is not allowed to vote in the meeting on the issue.

These issues must be addressed and can effectively limit the amount that can be guaranteed (e.g. to the net worth of the guarantor). It can be particularly difficult to establish corporate benefit for upstream guarantees. However, some case law has recognised the existence of a "group interest" which goes beyond the interest of the single company. Such "group interest" can justify the granting of upstream guarantees, provided that the grantor obtained some benefit, even if indirectly.

Priorities

In a bankruptcy, the ranking of creditors is regulated by the Bankruptcy Act and the Civil Code. The order is, in summary:

(a) claims associated with the bankruptcy proceedings as set out in a specific legislation (the recent reforms extended this category by including rescue finance);

(b) debts secured by a pledge or mortgage;

(c) debts having a general priority such as claims for salaries, social contributions, taxes; then

(d) unsecured debts.

Luxembourg

Key Elements:

- Considers the two main types of insolvency procedure:
  - Bankruptcy (*faillite*)
  - Controlled management (*gestion contrôlée*)
- The effects of insolvency proceedings on the rights of secured creditors
- Guarantees
- Ranking of creditors' claims
- Lender liability issues
- Directors' duties
- Recognition of foreign proceedings outside of the EU

General – Procedures

The standard insolvency procedures for commercial companies are bankruptcy proceedings (*faillite*). In addition, a controlled management procedure (*gestion contrôlée*) exists.

Other types of proceedings are the suspension of payments (*sursis de paiement*) and the pre-bankruptcy composition arrangements with creditors (*concordat préventif de faillite*) which are however only rarely used in practice and will not be analysed hereafter.

Specific insolvency procedures (such as for credit institutions, insurance undertakings or investment funds) are not analysed herein.

Controlled management (gestion contrôlée)

Controlled management proceedings (*gestion contrôlée*) can be opened only upon the application of a commercial debtor if such person establishes that its commercial creditworthiness is tainted or that the integral performance of its obligations is at risk and if it can show that the controlled management (*gestion contrôlée*) may allow it to reorganise its business and to return to a normal activity, or that such procedure will ensure a better realisation of its assets.

The procedure is subject to two different phases. During a first phase, while the management of the company stays in place, the company will in principle not be able to take any measures regarding its assets (in particular any measures of disposal) without the consent of the supervising magistrate appointed by the court. During this phase, the rights of creditors (including secured creditors except where specific laws provide differently) will be frozen. The approval of the appointed supervising judge will be required for all acts to be carried out by the debtor.

During a second phase, and following the nomination of a commissioner (*commissaire*), the approval of the commissioner will be required for either all or certain categories of decisions (as determined by the appointing judgment). The rights of creditors will continue to be frozen (as above). The commissioner draws up a reorganisation plan or a plan for distribution, which is subject to approval by a majority of creditors. It must then be approved by the court before becoming compulsory for the debtor and the creditors.

Controlled management proceedings (*gestion contrôlée*) are excluded (i) after bankruptcy proceedings (*faillite*) have been opened against the applicant, (ii) if the court considers that such measures would not have the purported effect, or (iii) if the court becomes convinced during the proceedings that the applicant has in fact stopped being able to make payments (in which case bankruptcy proceedings (*faillite*) may be opened immediately).

Bankruptcy proceedings (faillite)

Bankruptcy proceedings (*faillite*) can be opened upon the application of either the bankrupt company itself, upon application of any creditor, or upon an ex officio decision of the court. The conditions for the opening of bankruptcy proceedings (*faillite*) are the stoppage of payments (*cessation des paiements*) and the loss of commercial creditworthiness (*ébranlement du crédit commercial*). In addition, the failure of controlled management (*gestion contrôlée*) proceedings may also constitute grounds for opening bankruptcy proceedings (*faillite*).

As of the day of the opening judgment, the company's statutory officers (such as the board of directors) are divested of all powers to represent the company. The only legal representative of the company will be the bankruptcy receiver (*curateur*) who will be the only person entitled to take any decisions in relation to the assets. The bankruptcy receiver (*curateur*) is appointed by the Luxembourg commercial court.

As of the day of the opening judgment of the bankruptcy proceedings (*faillite*), all unsecured creditors have to file their proof of claims (*déclaration de créance*) with the clerk of the commercial court. Secured creditors may file proof of claims but they will only be registered for such amount which would not have been fully paid as a result of the enforcement of their security interests. There is no fixed duration for the bankruptcy proceedings (*faillite*), which will in normal circumstances last until such time as all claims have been verified, all assets have been realised, and distributions have been made to the creditors.

Counterparty's Ability to Exercise Rights of Termination under a Contract with the Debtor

The controlled management procedure (*gestion contrôlée*) provides in principle for the freezing of enforcement actions against the debtor during the establishment and until the adoption of the restructuring or liquidation plan or the rejection of the request. Termination clauses, declarations of default and subsequent acceleration are not effective against the debtor and do not prevent operation of the restructuring or liquidation plan.

Similarly, as from the opening of bankruptcy proceedings (*faillite*), all measures of execution against the debtor are suspended. The suspension of execution measures does however not prevent creditors from establishing their rights (either by taking conservatory measures or by starting court actions), as long as they do not seek execution of their claims.

Under bankruptcy proceedings (*faillite*), clauses for early termination acceleration and penalty due to the opening of bankruptcy proceedings are valid and enforceable. Furthermore, the opening of bankruptcy proceedings (*faillite*) automatically accelerates all debts, which are not yet due (there may be a discount for any debt not bearing interest and not due for a term of more than one year at the date of opening of bankruptcy proceedings (*faillite*)).

Security & Proprietary Rights

During a controlled management procedure (*gestion contrôlée*), the rights of secured creditors, privileged or not, are frozen until a final decision has been taken by the court except in limited circumstances where specific laws maintain enforceability.

Furthermore, as soon as a controlled management procedure (*gestion contrôlée*) has been opened, even if the debtor keeps his proprietary rights and the management of its goods and chattels, it needs to be authorised by the supervising magistrate (*jugecommissaire*) and, after his appointment, the commissioner for a vast range of actions relating to its business, like selling goods (chattels and real estate), borrowing or lending monies, paying creditors and granting pledges or assignment of claims (the exact scope of which is determined by the opening judgment).

Specific provisions of Luxembourg (substantive) law on pledges authorise the pledgee to continue enforcement regardless of the state of bankruptcy or liquidation, or any moratorium affecting the pledgor. This provision is however not applicable to controlled management procedures.

The law dated 5 August 2005 on financial collateral arrangements (the "Financial Collateral Law") disapplies the provisions of Luxembourg and foreign insolvency proceedings (including controlled management (*gestion contrôlée*) and bankruptcy proceedings (*faillite*)), in relation to financial collateral arrangements. This concerns pledges, transfers of ownership for security purpose and repurchase agreements relating to financial instruments (including securities, shares, etc.) and claims (including receivables and bank account balances), regardless of the status of the parties (i.e., none of them needs to be a financial institution).

This applies to Luxembourg financial collateral arrangements but also (subject to certain additional conditions) to equivalent foreign arrangements.

Reservation of Title

A doubt may arise for contracts containing a reservation of title clause: bankruptcy law (*faillite*) has made such clauses valid and enforceable, but given the special scope and aim of the controlled management (*gestion contrôlée*) procedure, it is doubtful whether the same rule will apply or if the special claim introduced by that law would be considered an enforcement action which is suspended until the end of the controlled management proceedings (*gestion contrôlée*). Further analysis would be required with respect to specific types of contracts.

Guarantees

A bankruptcy receiver (*curateur*) may have an interest in challenging guarantees granted by the insolvent company (in particular if the guarantee is secured). The first possible route would be to challenge guarantees entered into during the hardening period (i.e. the period preceding the opening of bankruptcy proceedings (*faillite*) by a maximum of six months (and up to ten days in certain circumstances)) if such guarantee was considered to be a gratuitous act or an act at undervalue or if the beneficiary of the guarantee had knowledge of the guarantor's stoppage of payments.

Alternatively, the bankruptcy receiver (*curateur*) might want to challenge a guarantee on (i) the lack of corporate benefit for the guarantor to grant the guarantee, and (ii) that the guarantee was granted for the personal benefit of one of the directors of the guarantor. In such case, the granting of the guarantee may possibly be assimilated to an abuse of corporate assets and, if established, could ultimately lead a court to declare the guarantee unenforceable.

Whether or not an abuse of corporate assets, the corporate benefit problem arises and is a question of fact that needs to be assessed, by the directors of the guarantor, on a case-by-case basis when entering into the agreement. Luxembourg law does not specify when there will be sufficient corporate benefit to permit the granting of a guarantee within one and the same group. In general, a company may grant guarantees to another company belonging to the same group if there is some common economic, social or financial benefit with regard to a common group policy. Even in these circumstances guarantees may not be granted without economic advantage nor if they upset the balance of commitments between the companies concerned. In addition guarantees may not exceed the financial means of the guarantor (often expressed as a percentage of net asset value/funds of the company.)

Very often, downstream guarantees are considered not to give rise to problems. For upstream and cross-stream guarantees, corporate benefit issues may arise. A possible manner to deal with this could be to require the amount guaranteed to be limited but, depending on the circumstances, other solutions might exist and, also, this solution alone may not always be sufficient.

Hardening Periods

Security interests may be challenged if they are granted during the hardening period (i.e. the period preceding the actual opening of bankruptcy proceedings (*faillite*) by a maximum of six months (and up to ten days in certain circumstances)) preceding the opening of bankruptcy proceedings (*faillite*) of the grantor (except for security interests governed by the Financial Collateral Law, as stated above). If the security is successfully challenged it is unenforceable. Where security has been enforced, such enforcement may be undone.

One ground of voidness is the creation of security for pre-existing debt during the hardening period (for instance, the creation of a new mortgage or pledge) by the failed debtor.

Luxembourg law provides for the unwinding of all payments and transactions for consideration where the party to the transaction was aware that the debtor stopped payments, if they took place during the hardening period.

Security may also be voided if there was a fraud on the creditors of the company regardless of the date.

Priority

There are complex rules on priority in bankruptcy. It is generally considered that certain creditors having general rights of preference (such as the preference rights for judiciary fees (including the fees and costs of receiver/liquidator), unpaid salaries, and various tax, excise and social security contributions) may rank ahead of creditors having a security interest over certain assets (in particular if the enforcement is not done by the creditor himself but by a third party such as the bankruptcy receiver (*curateur*)).

In relation to pledges, there is a risk that preferential creditors may, depending on the circumstances, rank ahead of a pledgee, although this risk can be excluded in specific circumstances. This risk does not exist in relation to transfers of ownership for security purposes.

Lender Liability

Lenders can be held liable if they have continued to lend in circumstances where the debtor is already in a suspension of payments or its financial position has deteriorated to an irreversible state. The lender is therefore deemed to be adding to the debtor's liabilities and reducing the likelihood of it being rescued (in particular if the lender is considered to have created or allowed to be created ê a false appearance of creditworthiness). Lenders can also be held liable if they revoke their commitment to lend funds to a debtor in an unexpected and abusive manner (for instance without giving notice or not sufficient notice) and thereby reducing the likelihood of the debtor to be able to pursue its business by getting the necessary financial means. In addition, liability may arise where the lender is acting as shadow director.

Directors' Duties

Directors are liable towards the company for any wrongdoing or negligence in the management of the company. They are furthermore liable towards third parties as well as towards the company for any losses suffered as a result of a violation of the company's articles or company law.

Directors may be criminally liable for any abuse of corporate interest they may have committed (Article 171-1 of the company law). Other criminal offences such as *banqueroute* and *banqueroute frauduleuse* with respect to actions taken in the context of or having lead to the bankruptcy of a company also exist. In particular, directors are obliged to file for bankruptcy within one month of cessation of payments.

Bankruptcy proceedings (*faillite*) may be extended personally to directors having, in particular, made use of the company's assets for their personal purposes or pursued, for personal reasons, the activity of a company that inevitably leads to its bankruptcy.

Recognition of Foreign Insolvency Proceedings

Within the EU

The Regulation applies, see first part of this note.

Recognition of foreign insolvency proceedings outside of the EU

As a general principle foreign insolvency proceedings regularly opened in another state not being a member state, are recognised directly without any specific formalities except to the extent such recognition would require local enforcement measures, in which case formal recognition needs to be sought from the Luxembourg courts.

Belgium

Key Elements:

- Considers the two main types of insolvency procedure:
  - Bankruptcy
  - Judicial reorganisation
- Considers the rescue regime applicable to certain financial institutions
- Looks at the impact of insolvency on the rights of third parties
- Deals with the challenges that can be made to transactions made within the "suspect period"

General - Insolvency Proceedings

There are two types of court-controlled insolvency proceedings under Belgian law, bankruptcy and judicial reorganisation (the Belgian moratorium procedure). An insolvent debtor may also with the agreement of its creditors proceed to a voluntary liquidation.

A specific rescue regime applies to financial institutions.

Bankruptcy

Bankruptcy proceedings facilitate the liquidation of the debtor's assets and the distribution of the proceeds amongst its creditors. A debtor must (and the creditors and the public prosecutor may) file for bankruptcy when it has consistently stopped paying its debts as they fall due and no longer has credit available to it. A company is declared bankrupt by a judgment of the court. Upon the declaration of bankruptcy, the directors' powers lapse and a court-appointed liquidator takes control over the company.

Judicial reorganisation

A judicial reorganisation offers creditor protection and is aimed at saving distressed economic activity. A debtor may apply for judicial reorganisation if its business is or will at short term become threatened by financial difficulties (a debtor's business is presumed to be under threat if its net assets have fallen below half of its stated share capital).

The debtor in principle retains its management powers but it may request the appointment of a mediator or court officer to assist it with the reorganisation. Creditors and other interested parties may in case of gross misconduct threatening the continuity of the debtor's business seek injunctive relief (including the appointment of an administrator to take control of the debtor's business).

Under a judicial reorganisation, the debtor can make a voluntary arrangement with one or more of its creditors, submit a collective reorganisation plan to a vote of its creditors, apply for court consent for the sale of all or part of its business, or do any combination of the foregoing.

Under a collective reorganisation, the debtor must devise and, if approved by more than half of the creditors in both number and value, implement a reorganisation plan. The plan may include measures to reduce or reschedule liabilities and interest obligations, swap debt into equity, or reduce its headcount. An approved reorganisation plan binds dissenting creditors, including secured creditors, provided that the plan provides for payment of interest on their claims and that repayment of their claims is not suspended for more than 24 or, if at the end of the initial suspension the debtor requests an extension and demonstrates that the suspended claims will be paid in full, 36 months.

If successfully implemented, the debtor is releases from all debts included in the reorganisation plan.

The judicial reorganisation regime does not apply to credit institutions, insurance and re-insurance undertakings, fund management companies, investment firms and settlement institutions.

Rescue regime for financial institutions

The rescue regime allows for certain measures to be taken by (i) the board of directors of these institutions, (ii) the National Bank of Belgium (the "NBB") or the Financial Services and Markets Authority ("FSMA"), as the case may be, and (iii) the Government, when a financial institution is facing financial difficulties.

First of all, the board of directors of credit institutions, insurance undertakings and settlement institutions in financial difficulties can deviate from any statutory restrictions on its powers (e.g. a requirement to seek the approval of the shareholders in case of a disposal of certain assets).

Furthermore, if a credit institution, insurance or re-insurance undertaking, investment firm, fund management company or settlement institution has to cope with financial difficulties, the NBB or the FSMA, as the case may be, can impose a grace period within which the situation must be remedied. If the situation is not remedied within this period, special measures can be imposed (such as, e.g. additional solvency, liquidity and profitability requirements, suspension of the exercise of the institution's business for a specific duration or replacement of directors, managers for a specific duration). Immediate measures can be taken, and the grace period can be dispensed with, in case of urgency.

Lastly, for systemically important credit institutions, insurance undertakings and settlement institutions, if the financial difficulties result in a financial stability risk for Belgium or for the international financial system, the Government is authorised to (i) nationalise this type of financial institution; or (ii) force their transfer to a third party. The nationalisation or transfer can take the form of an asset deal or a share deal. The decision must be submitted for approval to the courts.

Voluntary liquidation

A voluntary liquidation may be used as an alternative to court-controlled insolvency proceedings, provided that it is supported by a sufficient consensus among the creditors. A liquidator is appointed by the shareholders to liquidate the assets of the debtor to satisfy the creditors' claims. The commercial court must confirm the appointment. Before completion of the liquidation, the liquidator must submit the proposal for distribution of the proceeds to the commercial court for approval.

Counterparty's Ability to Exercise Rights of Termination under a Contract with the Debtor

Bankruptcy

The existing agreements to which the debtor is a party are not automatically terminated by virtue of the bankruptcy, but:

(a) The counterparty may terminate an agreement with the debtor during a bankruptcy if the agreement gives it the right to do so. An event of default or right of termination triggered by an application for or declaration of bankruptcy is valid and enforceable.

(b) The liquidator has the power to terminate any existing agreement. The counterparty may demand that the liquidator make his decision whether to terminate or continue a contract within fifteen days. If no decision is taken within that time, the agreement is deemed terminated by the liquidator. If the liquidator decides to continue an existing agreement, newly accrued payment obligations of the debtor under the agreement will be accorded a "super-priority" and will be paid first out of the proceeds of the bankrupt's estate.

Judicial reorganisation

The application for, or grant of judicial reorganisation to a debtor does not by itself terminate existing agreements. In fact, the application for or grant of judicial reorganisation cannot be the reason for the termination.

A counterparty may also not terminate an existing agreement with a debtor subject to reorganisation for prior default of the debtor, if the debtor cures the default within fifteen days of notice by the counterparty.

The debtor may, by notice to its counterparty within fourteen days of the opening of the reorganisation, decide not to perform certain agreements in the interest of the continuity of its business. Any termination indemnity resulting from such non-performance is in turn subject to the terms of the reorganisation.

Rescue regime for financial institutions

The special measures that may be taken by the NBB or the FSMA if a financial institution is experiencing financial difficulties can result in the partial or complete suspension of agreements concluded by the institution concerned (e.g. for a bank, this can result in the suspension of the obligation to return customer deposits).

In case of a nationalisation or transfer of assets of a financial institution by the Government, the existing agreements of the financial institution will remain in place. The Government will, however, not bound by any statutory or contractual approval or change of control clauses or any contractual pre-emption right or call option of a third party in respect of such transfer or nationalisation. The transfer or nationalisation cannot result in the termination or a right to terminate for the counterparties under the agreements concluded by the financial institution.

Voluntary liquidation

The commencement of liquidation proceedings does not terminate the existing agreements of a debtor. Contractual termination by the parties remains possible, even if the termination is motivated by the liquidation.

Proprietary Rights Security

Bankruptcy

Upon bankruptcy, all enforcement action against the debtor is suspended, except that notwithstanding the bankruptcy:

(a) Secured creditors (mortgagees, pledgees and holders of floating charges) can enforce their security after completion of the bankruptcy claims verification process (this is the process where the liquidator checks all submitted claims against the books and accounting records of the debtor). This normally implies for these creditors a stay of enforcement of about two months. In addition, the liquidator may ask the court to suspend individual enforcement for a maximum period of one year from the bankruptcy judgment, during which time the liquidator himself may sell the assets which are the subject of the security, if this is in the interest of the bankrupt's estate, and if this course of action is not detrimental to the secured creditors.

(b) Owners can claim repossession of their goods in the debtor's possession. This includes lessors who are thus not subject to a stay of enforcement. Claims for repossession must be filed prior to the completion of the bankruptcy claims verification process, failing which the ownership right may be lost. Special requirements apply to retention of title clauses.

(c) Security over assets in other jurisdictions remains enforceable in accordance with local rules.

(d) Contractual set-off arrangements remain enforceable.

(e) Security over financial instruments and cash accounts remains enforceable.

Rights of enforcement against third party guarantors or security providers are not affected by the suspension.

Judicial reorganisation

Upon application for reorganisation, all pre-reorganisation liabilities are frozen (but the debtor may still voluntarily pay these liabilities). New liabilities must be paid by the debtor on their due date and will be payable ahead of all ordinary and, in special circumstances, secured creditors, if the debtor subsequently becomes bankrupt.

During reorganisation proceedings, parties cannot apply for the bankruptcy or forced liquidation of the debtor. Enforcement action against the debtor, including the recovery by creditor-owners of their assets in the possession of the debtor, is generally suspended.

By way of exception:

(a) Security over assets in other jurisdictions remains enforceable in accordance with local rules.

(b) Contractual set-off arrangements remain enforceable.

(c) Security over receivables, financial instruments and cash accounts remains enforceable.

Rights of enforcement against third-party guarantors or security providers are not affected by the suspension. Security may be discharged by reason of a court authorised sale of the debtor's business in the context of a reorganisation, in which case the security will attach to the proceeds of the sale of the relevant assets.

Voluntary liquidation

A liquidation does not trigger any automatic stay of enforcement. Creditors will need to refrain voluntarily from taking action against the debtor in order not to frustrate a successful liquidation.

Voidable Transactions

Bankruptcy

The Belgian bankruptcy law contains voidable preference rules that challenge certain actions made by or with a bankrupt debtor during the pre-bankruptcy suspect period of up to six months. The following actions and payments are caught by the voidable preference rules:

(a) Disposals of assets made without consideration, or at a significant undervalue.

(b) Payments made in respect of liabilities that were not yet due and payable.

(c) Payments in kind, unless the payment in kind is an agreed enforcement method of a financial collateral arrangement.

(d) All transactions with a counterparty who had knowledge of the insolvency of the debtor.

(e) New security granted for pre-existing debts.

Rescue regime for financial institutions

Belgian law protects the measures taken by the Government in respect of distressed financial institutions against subsequent insolvency challenge. The insolvency rules that disallow payments in respect of unmatured debts, payments in kind, and transactions with counterparties who have knowledge of the insolvency of the debtor, are disapplied.

Judicial reorganisation

Belgian law protects certain payments and transactions made in the context of a judicial reorganisation against subsequent insolvency challenge. The insolvency rules that disallow payments in respect of unmatured debts, payments in kind, and transactions with counterparties who have knowledge of the insolvency of the debtor, are disapplied.

Directors

Belgian company law imposes certain duties on the formal directors of a company by virtue of their office. Generally, officers who do not hold a directorship must duly perform and execute their employment contract with the company but the company law does not impose any other specific legal duties on them. Belgian company law does not impose positive duties on shadow directors, but specific liabilities attach to shadow directors who as a matter of fact hold managerial power in a company.

As agents of the company, the directors owe their duties primarily to the company. Yet, the improper execution of their mandate in certain circumstances exposes the directors to liability to third parties for losses suffered as a result. In principle, any person other than the company can be an interested third party, save that a shareholder of the company will often not be able to bring an individual claim as a third party because his interests are, unless proven otherwise, deemed to be identified with the interests of the company.

Under Belgian company law, directors have a duty to act in the best interest of their company and to promote its corporate object. In particular, directors have:

(a) A duty of care as director

Directors are liable to their company for the improper execution of their mandate. The requisite standard of care and skill is that of a reasonably prudent and diligent businessperson.

The courts have only limited review powers and may not second-guess business decisions. Only obviously unacceptable behaviour can trigger the directors' personal liability. An action for liability on the basis of a breach of the duty of care can only be brought by the company, or the company's liquidator upon insolvency.

(b) A duty to abide by the company's statutes and the company law

Directors are liable to the company and to third parties on a joint and several basis for breaches of the company's statutes or the company law. Examples include a violation of the publication rules relating to certain corporate information, a breach of the conflicts of interest rules, a failure to comply with the procedures applicable to important losses of shareholder equity, etc. An action for liability on the basis of a breach of the statutes or the company law can be brought either by the company or by third parties who have incurred a loss as a result of the breach.

(c) A general duty of care

Like any other person, directors may be liable in tort for wrongful acts which cause damage to someone. An action for liability in tort can be brought by any person who has suffered a loss as a result of the tortuous act, but can only in limited circumstances be instituted by a person who also has a contractual relationship with the tortfeasing director (such as, for instance, the company).

(d) Specific liability upon bankruptcy

A specific form of liability applies in the case of bankruptcy of a company with insufficient assets available to meet the liabilities. The directors, former directors or shadow directors of the bankrupt company may, if they were grossly negligent in a way that contributed to the bankruptcy, be held personally liable for all or part of the liabilities of the company up to the insufficiency of the assets.

(e) Liability for failure to prepare and submit proper financial statements upon bankruptcy

The Belgian bankruptcy law provides that the liquidator of a bankrupt company must upon his appointment proceed with the auditing and correction of the financial statements of the company. If no financial statements are available, or if substantial corrections are required, the directors may be held personally liable for the costs of preparing or correcting the financial statements.

General Issues

Intragroup transactions

The same duties as set out above must be observed in connection with intragroup transactions. In addition, the directors should ensure that the intragroup transactions are on arm's-length terms and that intra-group services are remunerated at a normal market price. It should be noted that mandatory conflicts of interest procedures apply to situations where a director has a direct or indirect personal financial interest in a proposed transaction with his company (this could for instance be the case of directors holding an equity participation in the counterparty of the intra-group transaction).

Ongoing compliance obligations

Directors must comply with a number of ongoing obligations, such as to hold regular board meetings, to draw up and publish annual accounts and to file tax returns, etc. These obligations give rise to various criminal penalties and possible civil liability. In difficult times or in the period leading up to insolvency, these obligations often tend to be neglected. Irregularities in respect of these obligations may alert the bankruptcy monitoring service of the commercial court which conducts preventative investigations into financially troubled companies.

Obligation to propose liquidation to shareholders meeting

Belgian company law requires the board of directors of a company, when as a result of losses suffered, net equity falls below half of the company's share capital, and again when it falls below a quarter of the share capital, to call a meeting of shareholders which must decide whether to continue the operations of the company or to cease the operations and liquidate the company. Failure to do so in principle triggers the liability of the directors in respect of all liabilities that continue to arise or accrue after the date when the shareholders meeting should have been held. Furthermore, in case the net assets of the company have fallen below the applicable minimum statutory capital requirement, any third party will be able to petition the court for the liquidation of the company. This means in practice that the directors should on a regular basis assess the net equity position of their company.

Recognition of Foreign Insolvency Proceedings

Within the EU

The Regulation applies, see the first part of this note.

Recognition of foreign insolvency proceedings outside of the EU

A judgment obtained in foreign insolvency proceedings that falls outside the scope of the Regulation would be recognised and enforced by the courts of Belgium without review on the merits and subject to certain conditions, which mainly require that the recognition or enforcement of the foreign judgment should not be a manifest violation of public policy, that the foreign courts must have respected the rights of the defendant, that the foreign judgment should be final, and that the assumption of jurisdiction by the foreign court has not breached certain principles of Belgian law.

Germany

Key Elements:

- One type of proceedings, providing for liquidation, reorganisation or sale of the business
- Proceedings divided in preliminary and main phase
- Test for insolvency with regard to illiquidity and over-indebtedness
- Directors' duty to file for insolvency within three weeks
- Equity replacement and capital maintenance rules

Insolvency Regimes

The German Insolvency Code (*Insolvenzordnung*), which applies to all types of company, contains rules on the liquidation as well as the reorganisation of a debtor's business. In general, the Insolvency Code provides for uniform insolvency proceedings, which means that the commencement of proceedings does not depend upon the type of proceedings the petitioner intends to initiate. Whether the debtor is to be liquidated or reorganised will be determined by the creditors several weeks after the petition has been lodged.

The Insolvency Code is based on the concept of creditor independence. In the course of the proceedings all major decisions are taken or must at least be approved by the creditors. In some instances, however, the insolvency court may repeal resolutions passed by the creditors.

The insolvent company's business can be reorganised by transferring the valuable assets to a NewCo which can then be sold with the proceeds distributed to the creditors. The Insolvency Code also provides comprehensive rules regarding an "insolvency plan" (*Insolvenzplan*) through which the company as such can be reorganised if this seems feasible.

The Insolvency Code also allows for the management of the distressed company to continue to manage the company (*Eigenverwaltung*) under certain conditions. A specific creditors' trustee is appointed to monitor them in the interest of the creditors. This is comparable to debtor-in-possession proceedings.

German insolvency law does not recognise insolvency proceedings covering groups of companies. In general, insolvency proceedings are commenced for each company separately.

Test for Insolvency

The Insolvency Code lists three trigger points for the commencement of insolvency proceedings: illiquidity, impending illiquidity and over-indebtedness.

Illiquidity is defined as the debtor's inability to honour its payment obligations (now) due. This is generally indicated by the fact that the debtor has ceased to make payments. The debtor's illiquidity cannot be presumed if there is only a temporary delay in payments, for example, when the debtor's gap in liquidity can be closed by expected payments, new loans or the liquidation of assets within a short period of time (usually no more than two weeks). A petition for the commencement of insolvency proceedings on grounds of illiquidity may be made to the competent local court (*Amtsgericht*) either by the insolvent debtor or by a creditor.

Impending illiquidity means that the debtor will not be able to honour existing payment obligations when they become due. Since this is based on a prognosis, the court may require the debtor to submit a "liquidity plan". A petition on the grounds of impending illiquidity may only be filed by the insolvent debtor.

Insolvency proceedings based on over-indebtedness may only be commenced against legal entities. The debtor is over-indebtedness when its assets no longer cover its liabilities. This is determined by way of a pre-insolvency balance sheet (*Überschuldungsstatus*), which must value assets at their present liquidation values. Shareholder claims deriving from a loan provided to the debtor or of legal acts corresponding economically to a loan must be taken into account as a liability of the debtor unless the shareholder-creditor has formally subordinated his claim.

Even if it turns out that on the basis of the pre-insolvency balance sheet the assets do no longer cover the liabilities, the company is not over-indebted if under the given circumstances a continuation forecast demonstrates that the company's financial strength is sufficient to ensure its economic survival at least for the current and the following business year. However, from 1 January 2014 on, over-indebtedness will no longer be excluded per se by a likely continuation of the company.

A petition for the commencement of insolvency proceedings on grounds of over-indebtedness may be made either by the insolvent company or by a creditor.

The court will only make an order initiating insolvency proceedings where sufficient assets are available in the estate to cover the costs of the proceedings. These costs include court fees and the estimated fees and expenses of the preliminary administrator, the administrator and the members of the creditors' committee. If the debtor's assets are not sufficient to cover these estimated costs, the court will dismiss the petition unless an adequate advance payment in cash is made.

Insolvency proceedings

There are two distinct periods in the course of insolvency proceedings.

The first begins with the filing of the petition and usually lasts up to three months (so-called “Preliminary Proceedings”). The purpose of Preliminary Proceedings is to allow the court to gather all the information necessary to determine if the prerequisites for commencing insolvency proceedings are met. In general, the filing of a petition, and thus, the beginning of Preliminary Proceedings, does not affect the legal relationship between the creditors and the debtor by, i.e. triggering a moratorium. The insolvency court may - and will in practice - however, take any measures that appear necessary to protect the debtor’s estate against any adverse change in the debtor’s position until a decision with respect to the petition has been taken. Those measures usually include the appointment of a preliminary administrator (*vorläufiger Insolvenzverwalter*) and an order stipulating that transfers shall only be effective with the consent of the preliminary administrator and/or an order preventing creditors from executing their claims individually into the debtor’s assets (unless immovables are concerned). The preliminary administrator is not allowed to begin the liquidation of the debtor’s business without the court’s prior consent.

Preliminary Proceedings end when a court order initiating the commencement of the actual insolvency proceedings is made. An administrator (*Insolvenzverwalter*) will generally be appointed. The order also leads to a general stay of execution with regard to the claims of all creditors. Creditors may now only pursue their claims according to the provisions governing insolvency proceedings. In addition, any security interest which has been created by execution within one month prior to the filing of the petition will be void.

The administrator is in charge of managing the debtor’s business and making all necessary dispositions with respect to the estate. However, before entering into transactions which substantially affect the estate, he must obtain the consent of the creditors. The final decision whether to liquidate or reorganise the debtor’s business also remains with the creditors. If the company is wound up, the administrator is then responsible for distributing the proceeds to the creditors.

The Insolvency Code also contains a separate section dealing with self-management, or debtor-in-possession proceedings. If the debtor has applied for self-management and it is considered that this will not result in any disadvantage to the creditors, the court may order that virtually all responsibilities with respect to the estate remain with the debtor. In this event, the powers of the appointed trustee are generally limited to the supervision of the debtor’s economic circumstances, the debtor’s management and personal expenditures.

Creditors’ meetings are summoned by the insolvency court. The court sets a date for a first creditor’s meeting, the information hearing (*Berichtstermin*), usually between six weeks and three months after the court order opening insolvency proceedings. At the information hearing, the administrator reports on the debtor’s business situation and the causes of insolvency. He also reports on the possibility of reorganising the debtor’s business by means of an insolvency plan. The creditors decide whether the debtor’s business is to be terminated or provisionally continued. The creditors may also instruct the administrator to prepare an insolvency plan. The creditors may later reverse or amend their initial decisions. To adopt a resolution more than 50% by value of those creditors voting must be in favour. The court will also set a date for the examination hearing (*Prüfungstermin*), at which registered claims are examined to determine their value and rank. This meeting takes place between one week and two months after the date on which the period for registering of claims expires. The court may decide that the examination hearing, and the information hearing will take place together.

Insolvency plan

Under the Insolvency Code there is now a provision for the implementation of an insolvency plan (*Insolvenzplan*). The objective of such a plan is a solution by consent, normally involving the restructuring of the existing company, although such a plan may also be used to liquidate a company.

An insolvency plan can be formulated and submitted to the insolvency court by the administrator or the insolvent person. It can be adopted at any stage in the insolvency proceedings. There are few rules regarding the content of the plan (it is effectively a “contract” between the parties) although the Insolvency Code does regulate the formal make-up of such a plan. The Insolvency Code requires the creditors to be divided into groups for the sake of the plan. Such creditor groups or classes can be treated differently by the plan if good grounds exist. Within each group they must be treated equally.

The adoption of the insolvency plan is subject to the agreement of all creditor groups. The majority of creditors in each group must consent and these creditors must hold more than half of the value of claims within the group. In the event that a creditor group does not consent, the plan may still be adopted if the insolvency court establishes that the dissenting creditors would not be worse off with the plan than without the plan and the dissenting creditors have a reasonable share of the economic benefits of the plan. Once agreed, the insolvency plan must be confirmed by the insolvency court to be effective.

The execution and termination of the insolvency plan takes place according to its own provisions and is not part of the statutory insolvency proceedings. After the insolvency proceedings are terminated, the debtor recovers the power to dispose of its assets. These proceedings have only rarely been used in practice as shareholder consent is required and dissenting creditors may delay the implementation of the plan. The actual government draft act for a reform of the German Insolvency code (see below) may change this situation.

Priority of Payment and Preferential Creditors

Under German insolvency law, there are five different types of creditors. They may be distinguished by their degree of participation in the insolvency proceedings, the extent to which their claims are secured and the rank of their claims within the order of priority.

(a) Creditors with rights to the segregation of an asset (*Aussonderungsrecht*), such as in the case of goods subject to retention of title or (depending on the specific trust agreement) held by the debtor as trustee, can separate these assets from the estate. However, the administrator has powers to prevent a creditor from exercising its right to segregation of goods subject to retention of title by agreement assuming the executory contract.

(b) Creditors of the estate (*Massegläubiger*) do not participate in the actual insolvency proceedings, i.e. their claims will neither be registered nor examined within the proceedings. Claims of creditors of the estate include administrator's costs and liabilities and court costs, liabilities incurred by activities of the administrator, liabilities resulting from executory contracts that have been assumed and liabilities arising from the unjust enrichment of the estate.

(c) Creditors with a right to separate satisfaction (*Recht zur abgesonderten Befriedigung*) are creditors who participate in the insolvency proceedings, but at the same time are secured by collateral that constitutes part of the estate. The right of separation allows such secured creditors to claim the proceeds (in case of the realisation of security over moveable assets in the possession of the insolvency administrator or claims by an insolvency administrator less certain fees of usually some 9% on the proceeds payable to the estate) generated on the realisation of the collateral up to the amount of their secured claim. Any surplus belongs to the estate.

(d) Insolvency creditors (*Insolvenzgläubiger*) are unsecured creditors who have an established claim against the debtor at the time of the opening of the insolvency proceedings. The assets of the estate which remain after the claims of the creditors of the estate have been completely satisfied are distributed pro rata among all insolvency creditors. One of the major reforms of the Insolvency Code was to include employees and tax authorities in this group, who had previously enjoyed preferential status.

(e) The claims of subordinated insolvency creditors (*nachrangige Insolvenzgläubiger*) have the lowest priority among all claims in the proceedings. They are only satisfied after the claims of all insolvency creditors have been completely satisfied. Claims of subordinated insolvency creditors include claims for reimbursement of a shareholder's loan or similar claims, and claims for which subordination in insolvency proceedings has been agreed upon between creditor and debtor.

Directors' Liabilities

As soon as the directors of a company have reason to believe that the company is in financial difficulties they are legally required to establish the extent of such difficulties and to continue to keep the company's financial situation under review. In particular, they are obliged to ascertain whether the company has already lost half of its share capital or whether grounds exist for opening insolvency proceedings.

If the company's equity has been reduced to half or less of its share capital, the directors are required to inform all the company's shareholders immediately. Failure to do this may lead to personal civil liability for the directors and constitutes a criminal offence punishable by imprisonment of up to three years.

If a company is illiquid or over-indebted the directors have a duty to file a petition for insolvency without undue delay and within a maximum of three weeks. If attempts to rescue the company during the three week period fail, the directors have to file immediately. Failure to do so can result in criminal sanctions. In addition, they may be personally liable to the company and its creditors for any losses incurred due to the delay in filing. Note that each director is individually responsible for filing the petition.

In the case of impending illiquidity, the directors are entitled, but not obliged, to file a petition for the initiation of insolvency proceedings. However, it should be noted that directors who apply for insolvency proceedings prematurely (before they have explored all other possibilities) risk being personally liable to the company and its shareholders. An application for insolvency proceedings based only on impending illiquidity should not therefore be filed unless the shareholders, by means of a formal shareholders' resolution, have consented to the application or issued instructions to that effect.

Directors who enter into new agreements on behalf of the company which the company is unlikely to be able to fulfil, without informing the other party of the company's financial situation, risk being held personally liable for any damages arising. Entering into any such agreement may also constitute a criminal offence.

In principle, the directors are required to reimburse the company for any payments which they make to third parties out of the company's assets after the company has become over-indebted or illiquid, unless such payments would have been made by a prudent businessman in similar circumstances.

Directors may be liable for payments made to shareholders while the company is in financial crisis or if they make dividend payments in contravention of capital maintenance rules under company law. Supply, service or similar agreements will also be carefully scrutinised to ensure they were made on an "arm's length" basis.

Guarantees

Downstream guarantees are available in most circumstances. Upstream and cross-stream guarantees are subject to capital maintenance rules under company law. To avoid liability risks for its directors, a limited company (GmbH) will normally require documentation to be drafted so as to limit its obligations to any amount over and above its statutory capital.

If a public company (AG) grants an upstream or cross-stream guarantee, this may be regarded as a return on capital in breach of maintenance of capital rules even though its statutory capital remains untouched. An AG can usually only enter into a guarantee on the same terms as a third party would enter into such a guarantee (e.g. by being paid a market rate fee). A guarantee by an AG to secure acquisition of its own shares would be generally void under financial assistance provisions.

There is no need for a company to show corporate benefit when entering into a guarantee.

Lenders' Liability

Lending to a distressed borrower

German case law and legal literature do not consider the granting of a loan to a company in a crisis to be contrary to public policy, if it can be seen as a restructuring loan granted after a careful and competent assessment of the viability of a restructuring plan. Only under specific circumstances can lenders be held liable for third party damages incurred as a result of a delay in filing for insolvency (*Insolvenzverschleppung*), based on the overriding legal principle of violation of moral principles (*Sittenwidrigkeit*). In order to be held liable the lenders must have acted in a way which is incompatible with good faith.

Such incompatibility with good faith may be assumed if new credit is granted which, in the end, does not help to overcome the crisis but only delays the debtor's insolvency. In such a case, there is also a risk of criminal liability through aiding and abetting the directors' delay in filing for insolvency.

If lenders are liable for third party damages under the above principles, creditors who had existing claims against the company before the granting of a new loan can be entitled to compensation equal to the amount by which the dividend they receive in the company's insolvency is reduced as a result of the delay. Creditors whose claims arose after the credit was granted can be entitled to full compensation.

To avoid the risks described above, the lender will have to examine carefully the chances of a reorganisation of the borrower. A plausible business plan (*Sanierungsplan*) together with a workout opinion will be necessary, which must demonstrate that the company will be able to survive in the medium term if certain measures are met. Furthermore, a binding commitment by the parties involved in these measures will be required.

This business plan is usually drawn up by independent accountants. To avoid a risk of becoming liable for exerting harmful influence (e.g. shadow directorship), it should normally be ensured that the borrower itself appoints the accountant.

As it requires some time to prepare a restructuring plan and obtain an expert opinion on the feasibility of such plan, a bridging loan (*Überbrückungskredit*) to a company in crisis will not generally be considered contrary to public policy. Such a loan will not result in the lender being held liable if it is made in order to prevent illiquidity during the period required for the preparation and examination of the restructuring plan. However, the purpose of such a loan must only be to provide bridging finance during the time required to assess the feasibility of a restructuring of the company. A loan granted only to postpone insolvency and to enable the lender to improve its own position in comparison with other creditors would be considered contrary to public policy and could result in liability for the lender.

Control of borrower

In general a lender will not be liable vis-à-vis the borrower and/or its other creditors, provided that the borrower retains control of its operations. However liability may arise for the lender if:

(a) the lender deprives the borrower's management of its power to act for the company; or

(b) a person close to the lender (or the lender itself) assumes management powers; or

(c) a person close to the lender (or the lender itself) exerts substantial influence on the borrower.

In order for liability to arise, the lender's influence must be substantial and, ultimately, comparable to the influence of a shareholder.

Equity-Replacement and Capital Maintenance Rules

Shareholder loans

A shareholder loan (or a legal act corresponding commercially to a loan) will be generally subordinated to claims of other creditors by operation of law in the case of opening of insolvency proceedings over the company's assets. This rule does not apply, however, if (i) an existing creditor acquires shares with the intention to restructure the company (restructuring privilege) or (ii) a shareholder who is not involved in the management of the company only holds a participation of up to 10% of the shares (*de minimis* privilege).

Any repayment of a shareholder loan (or a legal act corresponding commercially to a loan) within a period of one year prior to the filing of the petition to open insolvency proceedings is subject to insolvency avoidance rules. The same is true for collateral provided for a shareholder loan within a period of up to ten years prior to the filing of the petition to open insolvency proceedings.

Capital maintenance rules

The nominal share capital for a *Gesellschaft mit beschränkter Haftung*, abbreviated GmbH, the most common corporate vehicle in Germany, is set out in its articles of association and registered in the Commercial Register of the company. The share capital must be maintained as a fund for creditors. As such, any payment by the company to the shareholder may only be made to the extent that such payment does not impair the company's nominal share capital. However, there are certain exceptions to this rule: Apart from payments made under a domination or profit and loss transfer agreement, these exceptions also concern payments to shareholders that are covered by a repayment claim in full, which provides for a sound legal basis for cash pooling schemes in the future.

Accordingly, a disbursement of funds from a company to a shareholder will not constitute a prohibited disbursement of assets as long as it is made as part of an 'asset exchange' i.e. if the company has a fully valid and enforceable claim for consideration or reimbursement in an amount equivalent to the sum disbursed to the shareholder. Whether such a claim is enforceable must be assessed in the light of the definition of the term 'fully valid'. Unforeseen developments that have adverse effects on a claim against a shareholder or the value of such a claim do not have the effect of rendering an initially permissible disbursement illegal. Nonetheless, a managing director may be held personally liable for not having made adequate use of existing possibilities to recover such funds in due time.

Moreover, any repayments of shareholder loans may be subject to insolvency avoidance rules within certain hardening periods. Payments to the shareholder made in violation of the above rule have to be reimbursed to the company. Similar rules apply to other incorporated German entities. Payments in the above sense are not only cash payments but also any transaction indirectly causing a contribution to the shareholder that would impair the company's nominal capital.

Furthermore, a shareholder of a GmbH or a public limited company must not abusively deprive the company of the liquidity necessary to continue its business. Otherwise the shareholder (besides the acting managing director) is liable for all damage arising out of the insolvency.

Antecedent Transactions

Transactions entered into prior to the filing of insolvency proceedings may be subject to insolvency avoidance rules within certain hardening periods. Within these hardening periods, a transaction may be declared void and unenforceable if it could be considered detrimental to other insolvency creditors. Any of the debtor's assets of which the estate has been deprived by means of a voidable transaction are to be returned to the estate.

For example, the following situations can lead to avoidance, described below with regard to the assignment of security:

(a) Any security given whilst the entity is in a position of illiquidity can be avoided if the beneficiary knew at the time of the taking of the security that the security provider was illiquid or if he had knowledge of circumstances that could lead to this conclusion. In these circumstances, the hardening period is three months prior to the filing of a petition for the commencement of insolvency proceedings.

(b) Security given which the security provider was not legally (e.g. contractually) obliged to assign. The hardening period is a minimum of one month, but an extended hardening period of up to three months prior to the filing of a petition for the commencement of insolvency proceedings applies if the security is given either at a time when the person providing the security is in a condition of illiquidity or if the beneficiary knew that the granting of the security would be detrimental to other creditors.

(c) Gratuitously given security: Third party security may be classified as having been gratuitously given on the grounds that the chargor itself receives no consideration or derives no benefit from the security assignment. The hardening period is four years.

(d) Intentional harming of other creditors: The security can be avoided if the granting of security by the insolvent company was directly detrimental to creditors and was perceived to "intentionally harm creditors" and if the beneficiary had knowledge of such. The hardening period is ten years.

(e) Taking of security by a person (or entity) with a close relationship to the debtor: Such security could be avoided if the granting of security by the insolvent company was directly disadvantageous to creditors, unless the beneficiary is able to show that he was unaware of the debtor's intention to act in a way that was detrimental to other creditors. The hardening period is two years.

(f) Repayment of shareholder loan: Any repayment of a shareholder loan (or a legal act corresponding commercially to a loan) within a period of one year prior to the filing of the petition to open insolvency proceedings is subject to insolvency avoidance rules. The same is true for collateral provided for a shareholder loan within a period of up to ten years prior to the filing of the petition to open insolvency proceedings.

Set-off

The general rule is that set-off which was available to a creditor prior to the initiation of insolvency proceedings remains available afterwards.

In the case where the creditor holds a debt which came into existence before the initiation of insolvency proceedings, but which could not be set-off prior to the initiation of insolvency proceedings, set-off may become possible during insolvency proceedings if certain conditions are met.

However, certain exceptions exist to the general rule. For example, a creditor may not use a claim for set-off that has been transferred to him from a third party after the initiation of insolvency proceedings, even if set-off was previously available to that third party. Set-off may also generally not be effected against a claim which has only arisen against the creditor after the initiation of insolvency proceedings.

Further exceptions apply which should be analysed on a case-by-case basis.

Draft act for the facilitation of company restructuring

A government draft act for a reform of German insolvency law is currently discussed in the legislative bodies. Its key objectives are:

- simplification of insolvency plan proceedings (e.g. by the implementation of a debt to equity swap against the will of the shareholders)
- facilitation of self-administration/ debtor-in-possession proceedings
- strengthening of creditors' rights (e.g. with regard to the appointment of the insolvency administrator)
- implementation of a pre-insolvency restructuring process

It is hard to predict the final outcome of the discussion and the date of coming into force of the reform. We believe the completion of the reform process to be likely during the course of 2011.

Recognition of Foreign Insolvency Proceedings

European Union

Under the Regulation, the opening judgment of one member state of the European Union is automatically recognised in Germany and comes into force without the need for prior recognition judgment of a German court. In general, the law applicable to these insolvency proceedings is that of the member state in which insolvency proceedings were opened.

After the opening of insolvency proceedings in another member state, German courts will only have the jurisdiction to open territorial insolvency proceedings in Germany if the debtor possesses an establishment within Germany, which will have to be liquidation proceedings restricted to the assets situated in Germany. (See the first part of this note for more details on the Regulation.)

Other states

On 20 March 2003, a new German international insolvency law entered into force which applies to states outside of the scope of the Regulation. It is an autonomous legal domain, fundamentally based on the Regulation's basis and system.

The opening of a foreign insolvency proceeding in another state not being a member state of the European Union is, as a general principle, recognised directly in Germany without any specific formality. This is however not the case,

- when the court which opened the proceedings does not have jurisdiction according to German law, or
- recognition would lead to a result which would be manifestly contrary to essential principles of German law, in particular its fundamental rights (*Grundrechte*).

Although the opening order of a foreign court will generally be automatically recognised in Germany, foreign court orders or security measures rendered in the recognised insolvency proceedings of another state may only be executed after being approved by a German court to be enforceable in accordance with the provisions of the German Civil Procedural Code (*Zivilprozessordnung*).

Creditors may file a petition for the commencement of separate domestic insolvency proceedings in Germany, if the debtor possesses an establishment in Germany or owns assets that are located in Germany. However, if the debtor has no establishment in Germany, the application for domestic insolvency proceedings can only be based on a special interest of the creditor to open such separate domestic proceedings, especially if the foreign insolvency proceeding would be clearly disadvantageous to the creditor compared to German insolvency proceedings.

Spain

Key Elements:

- One single procedure to facilitate restructuring or liquidation
- Security enforcement may be suspended for up to 1 year
- Directors' duty to file for insolvency within 2 months
- Set off not available after insolvency proceedings commenced

The Insolvency Law

The Insolvency Law (22/2003) was published in Spain on 10 July 2003.

The Insolvency Law encompasses all regulations applicable to Court insolvency proceedings, namely "*concurso de acreedores*," as opposed to out-of-Court liquidation, which is only available when the debtor has sufficient assets to meet all its liabilities. The Royal Decree Law 3/2009, 27 March 2009, has amended the Insolvency Law with respect to, among other issues, refinancing agreements, equitable subordination and classification of guaranteed debts.

A reform of the Insolvency Law is currently under discussion although legislation is not expected to be passed until the last quarter of 2011 and would enter into force sometime in early 2012.

General Notes on Insolvency Proceedings

Before analysing the procedural aspects and the effects of insolvency proceedings, the following general considerations should be made.

Subject

The same insolvency proceedings are applicable to all persons or entities (excluding Public Administrations, which may not become insolvent). These proceedings may lead either to the restructuring of the business or to the liquidation of the assets of the debtor.

The Insolvency Law is based upon the consideration that a company's insolvency does not always imply the insolvency of other companies of the group. However, certain rules try to coordinate the various proceedings being carried out in relation to companies pertaining to the same group.

Triggering point of insolvency proceedings

A debtor (if a company, its directors) is legally obliged to file for insolvency when it becomes insolvent, i.e., when it fails to meet its current outstanding obligations on a regular basis. This obligation must be fulfilled within two months as from when the debtor has or should have become aware of the insolvency situation. Failure to comply with this obligation triggers the assumption that the insolvency has been negligent (see below).

A debtor is entitled to apply for insolvency when it expects that it will shortly be insolvent. In this sense, insolvency proceedings are available as a type of legal protection that the debtor may request in order to avoid the attachment of its assets by its creditors.

The reform of the Insolvency Law has allowed the debtor to ask for an additional three month period to file, in order to allow the discussion of an advanced proposal for arrangement. In our view, this rule may not extend to refinancings, but may be limited to the discussions for an advanced proposal for an arrangement with creditors in the context of a company which is actually insolvent (On strict reading of the law it assumes that the insolvency filing shall be made once the three months period elapses, whether or not the arrangement is reached).

Costs arising from insolvency proceedings

The debtor must pay all costs arising from insolvency proceedings. The main costs are Attorneys' fees (usually to be paid at the beginning of the proceedings), Court Agent's fees (a "*Procurador*," is a mandatory go-between whose duty is to connect the Court with the parties, filing writs and receiving service of Court decisions) and the fees of the insolvency receivers (according to the assets and liabilities).

Procedural Aspects

Insolvency proceedings are formally initiated when the Court declares insolvency, following an application filed either by the debtor or by its creditors.

Application

The application for insolvency proceedings may be filed either by the debtor (if a company, the managing body - not the shareholders) or by its creditors. In the first case, they are named "voluntary insolvency proceedings"; in the second case, "necessary insolvency proceedings".

When the debtor files the application, it must include several documents (among others, a power of attorney, an explanation of the situation of the company, a list of assets and a list of liabilities, and the accounting books and records).

When a creditor files the application, it must provide evidence of its debt as well as of the insolvency situation. The latter may be proven as follows:

- When certain circumstances generally deemed as evidence of insolvency concur (such as failure to meet obligations with employees or tax liabilities during at least three months). In these cases, the debtor may challenge the petition either because the alleged facts do not concur or, even if they do, because the debtor is not insolvent.

- When enforcement proceedings have been carried out against the debtor in which assets have not been found to cover the amount claimed. In this case, the debtor would have no grounds to challenge the petition.

If the application is dismissed, the creditor would have to pay the corresponding legal costs and fees (and eventually damages caused).

Court decision declaring insolvency

When the debtor files the application, the Judge shall immediately issue a decision by virtue of which the insolvency proceedings will be initiated ("*auto de declaración de concurso*"). If it feels that the application does not comply with the legal requirements because the debtor has failed to include the relevant documents, it will grant a term in which the debtor must remedy such deficiency.

When a creditor files the application, the Judge shall hear the debtor before declaring insolvency by means of the referred Court decision; in the meantime, the Judge may adopt interim measures to ensure that the debtor's assets remain unaltered.

In any event, the following is determined in the initial Court decision:

- The identity of the receivers appointed by the Court (a lawyer, an economist and another economist, appointed by one of the main ordinary creditors to be elected by the Judge). For small insolvencies, the Court may (at its discretion) appoint only one receiver.
- Strictly speaking, receivers do not represent the creditors but act as court auxiliaries, on behalf of the debtor and are subject to strict liabilities, similar to those affecting directors of a company.
- The scope of the restrictions imposed on the debtor. The general rule is that, in the case of voluntary insolvency proceedings, the court receivers supervise the company activities, authorising (or failing to authorise) any payment or transaction. In the case of compulsory insolvency proceedings, the debtor would cease to manage its estate and the court receivers would take control of the company, being in charge of all further decisions.

First stage (determination of assets and liabilities)

The objective of the first stage of the insolvency proceedings is to determine the assets and liabilities of the debtor, leading to the preparation by the court receivers of the inventory and the list of creditors, respectively.

The insolvency order contains an express request for the creditors to notify their claims, within a one-month term following the publication of the insolvency declaration in the Official Gazette, providing original documentation to justify such claims.

Based on the documentation provided by the creditors and that held by the debtor, the court receivers shall draw up a list of acknowledged creditors and classify them according to the following categories:

- Secured Claims benefiting from special priority, representing attachments on certain assets (basically in rem security). These special priority claims entail separate proceedings, though subject to certain restrictions derived from a waiting period that may last up to one year (see below).

  These creditors are not subject to the arrangement (see further below), except if they give their express support by voting in favour of the arrangement. In the event of liquidation, they shall be the first to collect payment against the attached assets.
- Claims benefiting from general priority, including the claims of public authorities (in general, for half their amount), certain employee claims and the claims held by the creditor initiating the insolvency proceedings, up to a quarter of the amount of such credit.

  The holders of general privileges are not affected by the arrangement (if they do not consent) and, in the event of liquidation, they shall be the first to collect payment, in the order established under law.
- Ordinary claims, mainly trade creditors and lenders (when not secured or subordinated).
- Subordinated claims, thus classified by virtue of an agreement or pursuant to law, including debt held by related entities: shareholders owning at least 10% of the share capital (5% if a listed company) or group companies.

  Subordinated creditors are second-level creditors; they may not vote on an arrangement and have very limited chances of recovery. Through these restrictions, the law tries to encourage the conversion of their debt into shares or company participations (consent of existing shareholders would be necessary for this purpose).

  When subordination arises from a special relationship, the creditor will also lose any security over assets belonging to the debtor.

There are other claims not subject to the insolvency proceedings and that are therefore neither acknowledged nor classified. These include any claims accrued after the insolvency proceedings (e.g. those entered into order to continue the business) as well as other claims prescribed by law, even if accrued earlier (i.e. salaries accruing during the last 30 days before the proceedings are initiated). These claims are immediately payable, although the Insolvency Law imposes some restrictions on their enforceability.

Second stage: arrangement or liquidation

The second stage may lead either to an arrangement between the debtor and its creditors, or to the liquidation of the debtor's assets.

As an exception, in certain cases the debtor may propose in the course of the first stage of the proceedings an advanced arrangement, or may request that the liquidation is anticipated.

- An arrangement (*convenio*) may be entered into between the debtor and the majority of the creditors, involving a delay in payment or a partial cancellation of debts (as a general rule, with the limit of five years or one half of the debts, respectively). The arrangement is approved with the support of half of the ordinary creditors. However, in certain cases simple majority would be enough.

  The proposal for arrangement may be filed during the first stage of the proceedings (as an "advanced proposal for arrangement"). However, it would not be approved until the first stage of the proceedings have concluded.

  The arrangement is not effective until the Court gives its approval: the Court may refuse to do so when there has been a breach of law or when the insolvency receivers feel that the debtor will not be able to fulfil the arrangement. Once approved, no further appeals against the arrangement are possible.

  Although upon approval of the arrangement most effects of insolvency proceedings cease, the proceedings do not terminate until the terms of the arrangement are completely fulfilled.

- In case of liquidation, the debtor ceases to manage its assets (if a company, its directors would cease to act). The court receivers liquidate the debtor's assets by selling them, in order to distribute the money obtained among the creditors according to the rules established by the Insolvency Law (as explained above).

Effects of Insolvency Proceedings

The initial Court decision declaring the insolvency determines the initiation of the effects of the insolvency proceedings. The varying effects of the insolvency proceedings on other Court proceedings, bilateral agreements, obligations and prior transactions are set out below.

Other proceedings

As a general rule, insolvency proceedings are not compatible with other enforcement proceedings. When compatible, in order to protect the interests of the debtor and creditors, the Law extends the jurisdiction of the Judge dealing with insolvency proceedings, who is, in the future, legally authorised to handle any enforcement proceedings or interim measures affecting the debtor's assets (whether based upon civil, employment or administrative law).

Arbitration proceedings will continue if they had been initiated before the insolvency declaration.

In rem security

Creditors holding security "in rem", that had been traditionally allowed to enforce their claims against the secured asset notwithstanding the initiation of insolvency proceedings, are also subject to certain restrictions in relation to commencing separate enforcement proceedings (or to continue with such proceedings, if they had already been commenced).

When the secured asset is necessary for the debtor's activities, enforcement by the creditor is subject to a delay for up to a maximum of one year. It means that, following the declaration of insolvency, enforcement of security will no longer be possible until: (i) an arrangement is approved that does not bind such creditor (this is the general rule, except if the creditor gives his approval to the arrangement) or (ii) one year elapses from the date of declaration of insolvency without the arrangement having been approved or the liquidation stage has been initiated.

If the liquidation stage is initiated before the abovementioned one-year term, the creditor loses the opportunity to enforce the asset by means of separate enforcement proceedings. In any case, the proceeds would be used to pay the secured creditor.

Interest and set-off

Following the initiation of insolvency proceedings, interest no longer accrues (with the exception of secured creditors). Interest already accrued is considered to be a subordinated debt.

Set-off is applicable, provided that the legal requirements have been met before the company was declared insolvent. Set-off will no longer be possible after insolvency proceedings are initiated. Hedge agreements are subject to specific regulations, allowing close-out netting and enforcement of collateral.

Bilateral agreements

The declaration of insolvency does not, per se, allow the parties to terminate a bilateral agreement, notwithstanding what has been agreed upon by the parties. In other words, clauses allowing any of the parties to terminate a bilateral agreement due to the insolvency of the contractual counterpart would not be valid.

In principle, the declaration of insolvency does not alter the general contractual rules on termination. Therefore, following a default (either before or after insolvency is declared), the other party would be entitled to terminate the agreement and to receive compensation for damages caused (depending on when the default was committed, compensation will be, respectively, a pre or post-insolvency claim).

However, the Insolvency Law states the following exceptions to the general contractual rules:

- The Judge may decide to cure an eventual default of the insolvent party, thus re-stating the agreement (as if the default had never existed). If this is the case, outstanding amounts and further payments under the agreement will be post-insolvency claims, immediately payable.
- If the Court deems it convenient, the insolvent party will be entitled to terminate the agreement at any time. If this is the case, the counterparty will receive compensation for such termination, to be established by the Court dealing with the insolvency.

There are specific rules for employment agreements, mainly affecting dismissals.

Prior Transactions: Claw-back

Under the Insolvency Law there are no prior transactions that automatically become void as a result of initiation of the insolvency proceedings.

The court receivers may challenge those transactions that could be deemed as having "damaged" the debtor's interests, provided they have taken place within two years prior to the declaration of insolvency (transactions taking place earlier than two years before insolvency has been declared are not subject to challenge).

Those transactions which shall be reputed as "ordinary course of business" transactions, are not subject to challenge.

Legal presumptions of damage

"Damage" does not refer to the intention of the parties, but to the consequences of the transaction on the debtor's interests.

Damage is deemed to exist, in any event, in case of gifts and pre-payment of obligations becoming matured after the declaration of insolvency.

Damage is also deemed to exist, as a rebuttable presumption, in the case of rights in rem that have been created in order to protect already existing obligations.

Refinancing agreements

Under the Insolvency Law claw-back regime, the court receivers are allowed to challenge acts and agreements executed in the context of a refinancing:

- Payment of existing obligations when not yet due and payable is deemed to be detrimental for the insolvency estate, as a non rebuttable presumption, when such obligations had otherwise become due and payable after the insolvency declaration (this may be the case when the borrower uses the new financing to cancel existing obligations that were not due and payable or in the case of a debt for asset swap).
- The creation of additional in rem security to guarantee existing (non secured) obligations or new obligations created in exchange for the (non secured) existing ones, is deemed to be detrimental, unless proved otherwise (which, according to case law, is extremely difficult).
- As regards a refinancing, legal presumptions do not apply, but some insolvency judges have considered that the fact that the borrower finally becomes insolvent would show that the refinancing was detrimental for the insolvency estate.

The amendments introduced by Royal Decree 3/2009 are aimed at reducing the risk of claw-back under certain circumstances, thus facilitating certain refinancing agreements between financial entities and companies in distress. The drafting of the legislation still leaves the Judge a certain margin of discretion in order to decide whether the transaction is challengeable or not.

Pursuant to the new Additional Provision Four of the Insolvency Law, a refinancing agreement would not be subject to claw-back if certain conditions are met.

- A refinancing agreement is deemed to be a transaction providing for:
  - A "significant" increase of the available funds, or
  - A novation of the existing obligations (as a result either of the extension of the term, or the establishment of obligations to replace the existing ones).
- Requirements to be met by such a refinancing deal in order to be aside from the claw-back regime are the following:
  - Formalities: the agreement is executed in a public instrument enclosing all of the documents that justify the fulfilment of the requirements set out below.
  - Creditors approval: the agreement is signed by creditors representing at least three fifths of the debtor's liabilities (including non financial liabilities, e.g. trade creditors) at the date of the adoption of the refinancing agreement.
  - Viability: the agreement responds to a viability plan that enables the continuity of the debtor's business in the short and medium term.
  - Independent opinion: An expert appointed by the mercantile registrar of the debtor's registered

office (under the procedure laid down in the Commercial Registry Regulations) shall provide a report with his technical view on the adequacy of information provided, reasonability and feasibility of the viability plan and proportionality of the security taken, taking into account market conditions at the time of signing the agreement.

Insolvency Liability

The declaration of insolvency generally involves an incidental procedure in order to examine if civil responsibilities arise that caused or contributed to the insolvency ("insolvency specification proceedings").

Insolvency liability and other sources of liability

Under Spanish company law, directors are liable for damages and for debts:

- For damage caused through acts violating company law or the company's by-laws, or acts undertaken without the necessary diligence. In cases of insolvency, directors have been found liable for damage caused, intentionally or by gross negligence, by making certain decisions (e.g. entering into agreements) while possessing knowledge of the loss to be caused to third parties as a result of the company's inability to comply with its obligations.
- For future debts, when the company's assets have fallen below half of its share capital and the imbalance has not been remedied (e.g. by means of a capital increase or reduction) in two months. The directors must take all legal steps to initiate the wind-up and liquidation of the company by calling a general shareholders' meeting for this purpose. If this meeting does not resolve to liquidate the company, the directors must initiate the compulsory liquidation of the company through the Courts.

Under an insolvency scenario, the directors are obliged to file for insolvency within two months (subject to a further three month extension, as explained above) as from the moment in which they become aware or should have become aware that the company is insolvent (it is a cash flow test). Should they fail to comply with this obligation, they could face civil liabilities in the context of the insolvency specification proceedings.

Should the compulsory liquidation scenario and the insolvency situation coincide, the directors would be obliged to file for insolvency proceedings (within the referred two months time); otherwise, they would face not only the liability for the company's debts, but also the penalties arising from the insolvency legislation.

Aside from the insolvency proceedings, a criminal claim may be filed against the directors of the company, in order to examine their criminal liabilities. In general, criminal liabilities would not arise as a result of financial distress except if the directors have committed criminal offences in such context, such as unfair or fraudulent management or false accounting.

Insolvency specification proceedings

The insolvency specification proceedings are only developed when the insolvency leads to liquidation or when creditors accept a severe delay or cancellation of their claims as result of matters beyond the debtor's control (more than three years' delay or one third cancellation of such claims, respectively).

Incidental proceedings may lead to the conclusion that insolvency has been either the result of matters beyond the debtor's control or negligent, according to the circumstances prescribed by law (in this regard, the status of the accounts and compliance with the legal duty to apply for insolvency proceedings is essential).

- If the insolvency is deemed to be negligent, the directors or third parties (as "accomplices") may be liable to pay damages for the loss caused to creditors as a result of their actions.
- In case of negligent insolvency leading to liquidation, directors of the company may also be obliged to face outstanding company debts. The judges enjoys a wide range of discretion. The scope of this provision is pending clarification by the Courts.

Cross-border Insolvencies

According to the principles established by EC Regulation 1346/2000, the Court with jurisdiction over the proceedings is determined by the place in which the debtor carries out its main activities (in principle, the registered office). These proceedings are considered the "principal insolvency proceedings".

In addition, insolvency proceedings may be carried out where the debtor has a "permanent place of business". These "territorial insolvency proceedings" have a limited scope, only affecting the assets and creditors located in that country.

The Netherlands

Key Elements:

- Procedures for:
  - Bankruptcy
  - Suspension of payments
- Priority of payment and preferential creditors
- Directors' duties
- Lender liability
- Challenging antecedent transactions
- Set-off

Insolvency Regimes

Bankruptcy and suspension of payments

The Dutch Bankruptcy Act ("*Faillissementswet*", the "Act") entered into force on 1 September 1896 and has been amended several times since. At present, it contains three types of proceedings:

(a) bankruptcy (*faillissement*);

(b) suspension of payments (*surseance van betaling*); and

(c) debt reorganisation for natural persons (*schuldsaneringsregeling natuurlijke personen*).

Special proceedings and provisions for the insolvency of insurance companies and credit institutions are provided for in the "*Faillissementswet*" in conjunction with the Financial Supervision Act (*Wet op het Financieel Toezicht*).

A substantial revision of the Act was prepared by the Insolvency Law Committee (*Commissie Insolventierecht*), installed by the Minister of Justice. A draft for a new Insolvency Act was published in November 2007. However in the beginning of 2011, after consultation with relevant stakeholders and further consideration, the Minister of Justice concluded that he did not see a need to convert this draft into legislation. There is currently no visibility on an alternative comprehensive draft aimed at reform of the Dutch Bankruptcy Act.

Bankruptcy

Bankruptcy is a general attachment on (practically) all of the assets of a debtor, imposed by a judgment of the appropriate District Court (*Rechtbank*) for the benefit of the insolvent debtor's collective creditors. The objective of the bankruptcy is to provide for an equitable liquidation and distribution of (the proceeds of) the debtor's assets among its creditors. In practice, however, bankruptcy proceedings serve as an important instrument for the reorganisation and continuation of businesses in financial distress.

According to the Act, bankruptcy proceedings can be opened in respect of any debtor, natural or legal person, regardless of whether he carries on a business, practises an independent profession or not. The Act also provides for the opening of a bankruptcy proceeding in respect of a commercial partnership (*vennootschap onder firma*). A commercial partnership does not have legal personality, but its partners are jointly and severally liable and its assets form a separate fund available only for recourse by the partnership's creditors. If a bankruptcy proceeding is opened in respect of the partnership, simultaneously bankruptcy proceedings are opened in respect of the partners.

The Act does not provide for the consolidation of bankruptcy proceedings opened in respect of companies belonging to the same group. However, there are some examples of cases in which courts have allowed such consolidation.

If a bankruptcy proceeding is opened, the debtor loses the right to manage and dispose of his assets with retroactive effect to 00.00 hrs. of the day the bankruptcy order is issued. The court appoints a receiver who is charged with the management and realisation of the debtor's assets (including by means of a transfer of (part of) the business as a going concern). The receiver acts under the general supervision of a supervisory judge (*rechter-commissaris*). For certain acts of the receiver the law requires the (prior) authorisation of the supervisory judge, e.g. for conducting legal proceedings and for terminating employment and rental contracts.

Suspension of payments

Suspension of payments is a court-ordered general suspension of a debtor's payment obligations; its objective is to provide an instrument for the reorganisation and continuation of viable businesses in financial distress. It is available only at the request of the debtor and only has effect in respect of ordinary (non-secured and non-preferred) creditors. During the period for which the suspension of payments has been granted, creditors with non-preferential claims cannot take recourse in respect of the debtor's assets.

Despite several amendments made over the years to increase the effectiveness of the suspension of payments proceeding (e.g. the liberalisation of the conditions for the granting of a suspension of payments and the introduction of the possibility of a composition) it has in practice never become a satisfactory instrument for the reorganisation of businesses in financial distress. Generally, it is nothing more than a first step towards bankruptcy. Although there have been examples of successful suspension of payments proceedings in the early 2000s, e.g. the reorganisations of Versatel, GTS Europe and UPC, as far as reorganisation of businesses in financial distress is concerned, the bankruptcy proceeding in practice proves to be a more effective instrument than a suspension of payments.

Suspension of payments proceedings can be opened in respect of natural persons carrying on a business or practising an independent profession and juristic persons. The suspension of payments may be granted by the court for a maximum period of one and a half years and may be prolonged at the request of the debtor (if necessary more than once) with a maximum of one and a half years.

As a result of the granting of a suspension of payments, the debtor can no longer manage and dispose of its assets without the co-operation or authorisation of a court appointed administrator. Likewise, the administrator cannot act without the co-operation or authorisation of the debtor. The suspension of payments order has retroactive effect to 00.00hrs of the day it has been issued. In a suspension of payments proceeding, the court may appoint a supervisory judge, whose role is limited to regulating certain procedural matters and advising the administrator upon his request.

Restructuring outside bankruptcy

Since the start of the credit crisis in 2007, there has been an increasing demand for a mechanism to implement contentious, complex and multi-jurisdictional restructurings. Under Dutch law, two possibilities have been presented in practice by Clifford Chance.

Firstly, a pre-pack solution was successfully implemented through a court enforcement of a share pledge in the Schoeller Arca matter. It was the first Dutch court ruling in respect of a Dutch pre-pack whereby an enforcement sale of a Dutch holding company is pre-agreed between a buyer, the company and its senior lenders, while its subordinated bridge lenders opposed to the proposed sale. Since the Schoeller Arca judgment, more similar Dutch "pre-packs" have been implemented. Secondly, the possibility of implementing an English law Scheme of Arrangement in relation to a Dutch debtor is being considered, but has not yet been tested in a Dutch court.

Obligation to file for insolvency

There is no legal obligation for a debtor to file a bankruptcy petition or to apply for suspension of payments.

The test for insolvency

Bankruptcy

A debtor can be declared bankrupt if it has ceased to pay its debts. The court has relatively wide discretionary powers in assessing whether the debtor has ceased to pay its debts. The court may already come to such a conclusion if there is more than one creditor and at least one matured debt remains unpaid. Bankruptcy proceedings may also be opened in case of the debtor's unwillingness to pay, not only in case of its inability to pay. Balance sheet insolvency is no separate ground for the opening of bankruptcy proceedings.

Suspension of payments

If the debtor, according to its application, anticipates that it will not be able to continue to meet its liabilities as they become due, the court immediately grants a provisional suspension of payments. The court may not grant the definite suspension of payments if (i) a qualified minority of creditors with non preferential claims objects, (ii) if there is well-founded fear that the debtor will prejudice the interests of creditors during the period of suspension of payments or (iii) if there is no prospect of the debtor being able to satisfy its creditors within a certain period of time. That the debtor must be able to satisfy its creditors does not mean that they must be paid in full. It suffices that creditors can be satisfied to some extent, for example by receiving a percentage of their claims within the framework of a composition.

Initiation of insolvency regimes

Bankruptcy

The debtor, its creditor(s) or the Public Prosecutor (for reasons of public interest) may petition for the debtor's bankruptcy by filing a request to the appropriate District Court. Furthermore, in a number of cases the court can open a bankruptcy proceeding following a suspension of payments proceeding.

Suspension of payments

Only the debtor itself can apply for a suspension of payments at the appropriate District Court, on the grounds that the debtor anticipates that it will not be able to continue to meet its liabilities as they become due.

Moratorium

Both in the bankruptcy and the suspension of payments proceedings, the court (and in case of a bankruptcy proceeding: also the supervisory judge) may grant a "cooling down" or "freezing" period (moratorium). During such period, creditors with rights in rem (including rights of pledge and mortgage) cannot repossess or foreclose without prior approval by the court or the supervisory judge. The moratorium does not involve an obligation of financiers to continue to finance the debtor. Furthermore, rights of creditors against third parties are not affected by a moratorium.

A moratorium can be ordered for a maximum period of two months, which can be extended once by a maximum period of two months.

Rules Governing Priority of Payment and Preferential Creditors

Bankruptcy

In a bankruptcy, creditors with insolvency claims are entitled to the proceeds of the realisation of the debtor's assets. Costs incurred within the framework of the realisation of the assets give rise to claims against the bankrupt estate; these claims have to be satisfied in priority to insolvency claims. Claims against the estate include the receiver's salary, fixed by the court on the basis of a generally accepted hourly rate, and debts incurred by the receiver in continuing the bankrupt debtor's business and/or during liquidation.

Often the proceeds of the realised assets are insufficient to satisfy all claims against the estate. In that case, the claims against the estate are satisfied in accordance with the same ranking that applies between insolvency claims.

Creditors with a right of pledge or mortgage are, in principle, not affected by claims against the estate. As a general rule, there is no apportionment of the general realisation costs over the proceeds of the assets subject to a right of pledge or mortgage.

Unsecured creditors with insolvency claims can only enforce their claims against the debtor in the manner prescribed by the Act, i.e. by submitting their claims to the receiver within the framework of the claims validation procedure. Creditors with insolvency claims secured by a right of pledge or mortgage, can enforce their rights as if a bankruptcy proceeding had not been opened.

The law attaches a priority in the realisation proceeds to certain categories of claims (preferential claims) and determines the ranking of these preferential claims. A claim can have priority in respect of the realisation proceeds of a particular asset (e.g. resulting from a security right or a right of retention) or in respect of the realisation proceeds of all of the debtor's assets (e.g. the claims of tax authorities).

As a general rule, preferential claims in respect of a particular asset have a higher ranking than preferential claims in respect of all assets.

As to the preferential claims in respect of a particular asset, as a general rule, secured claims have a higher ranking than other preferential claims in respect of that particular asset. An important exception to this rule is that, in respect of the proceeds of the realisation of inventory situated on the debtor's premises, the tax authorities' preferential claim (in respect of certain taxes) has a higher ranking than a non-possessory right of pledge vested in such assets. A further exception to the above rule is that a right of retention may, in a particular case, have a higher ranking than a right of pledge or mortgage vested in the asset concerned.

Creditors can agree to a lower ranking of their claims. A contract between the creditor and the debtor may stipulate that the claim of the creditor is subordinated to all or to certain other claims of other creditors.

Shareholders have no right to any distribution of the proceeds within the framework of the proceeding as, under Dutch law, they are not creditors.

Suspension of payments

The suspension of payments only affects non-preferential claims existing at the time of the opening of the proceeding. During the proceeding, these claims cannot be enforced against the debtor's assets and payment of these claims can only be made to all creditors in proportion to their claims.

Preferential claims (including claims secured by a right of pledge or mortgage) are not affected by the proceeding and can, therefore, be enforced against the debtor's assets. This also applies to claims against the estate, i.e. obligations incurred by the debtor with the cooperation or authorisation of the administrator after the opening of the proceeding (e.g. in connection with the continuation of the debtor's business).

Other unsecured creditor actions

The Dutch Code of Civil Proceedings provides for a means of pre-judgment attachment, which is referred to as a "conservatory attachment" (*conservatoir beslag*). With a conservatory attachment a creditor can secure payment by the debtor in anticipation of an enforceable judgment against the debtor. Once the proceedings on the merits result in an enforceable judgment against the debtor, the conservatory attachment becomes an attachment in execution by operation of law, i.e. the attached assets can then be executed.

During the period of attachment the transfer or encumbrance of the attached goods by the debtor has no legal effect vis-à-vis the party that levied the attachment, i.e. the party that levied the attachment can proceed with the attachment as if the attached goods were not transferred or encumbered, unless the purchaser acted in good faith and has acquired possession of the attached goods. Furthermore, the withdrawal of the goods subject to the attachment will constitute an unlawful act and a criminal offence.

The nature of the conservatory attachment can be, amongst others, an attachment by garnishment (i.e. attachment of bank accounts), an attachment of shares or an attachment of assets or real estate.

As a result of the opening of bankruptcy proceedings in respect of the debtor, pre-bankruptcy attachments by creditors are lifted by operation of law and executions of assets included in the bankruptcy proceeding are automatically terminated. As a result of the opening of suspension of payments proceedings, only existing attachments levied by non-preferred creditors are lifted by operation of law; executions of assets included in the proceedings are not terminated but suspended.

Scope for majority voting and/or cram down of minority creditors

Bankruptcy

A bankruptcy proceeding does not always lead to the liquidation of the debtor's assets. The proceeding may also result in the reorganisation of debts by means of a composition. A composition can only be proposed by the debtor and, upon approval and confirmation by the court, only binds creditors with non-preferential claims (ordinary, non-secured and non-preferred creditors). Creditors with preferential claims are not bound by a composition.

Only creditors with non-preferential claims have the right to vote on the proposed composition. A composition needs the approval of a normal majority of the (conditionally) admitted creditors with non-preferential claims, representing at least half of the total amount of (conditionally) admitted non-preferential claims.

Upon request by the debtor or the receiver, the supervisory judge can decide to hold the proposed composition as approved, if (i) 3/4 of the (conditionally) admitted creditors approved the composition and (ii) the rejection of the composition is caused by one or more creditors that, taking all circumstances in consideration -especially the percentage of its claim that such creditor would receive in case the estate is liquidated and distributed reasonably could not have voted against the composition.

Suspension of payments

In a suspension of payments the debtor also has the option of proposing a composition. A composition only binds the creditors with non-preferential claims. The regulation of this composition (*grosso modo*) corresponds with the regulation of the composition in a bankruptcy proceeding.

Courts' responsiveness to creditors

Bankruptcy

The court may appoint a creditors' committee, which in practice, however, is exceptional. If a creditors' committee has been appointed, the receiver is obliged to provide it with all requested information concerning the bankruptcy. In certain cases, the receiver is obliged to seek the advice of the creditors' committee. The receiver, however, is not bound by the committee's advice.

The Act also provides for meetings of creditors to be convened. With regard to certain matters, the law prescribes a meeting of creditors. Decisions concerning the admission of claims must for example be taken in a meeting of creditors, as well as the decision to continue the company's business if a composition has not been offered or has been rejected.

Creditors may submit a petition to the supervisory judge requesting the supervisory judge to order the receiver either to perform certain acts or to refrain from performing certain intended acts. Furthermore, a creditor may request the court to dismiss the receiver.

Suspension of payments

The influence of creditors in the proceeding is limited. The court is obliged to hear their views when deciding whether or not to definitively grant the suspension of payments; when a certain number of creditor's objects, the suspension of payments cannot be granted definitively. Any creditor can request the court to dismiss an administrator. Furthermore, any creditor can request the court to take the measures necessary to protect the interests of the creditors. Creditors may also request the court to terminate the suspension of payments.

In contrast with a bankruptcy proceeding, creditors do not have the option to request the supervisory judge to order the administrator to perform or refrain from performing certain acts.

Directors

The law imposes duties on the following persons:

(a) Managing Directors (*bestuurders*); and

(b) Supervisory Directors (*commissarissen*).

Directors' duties

The Managing Directors' duties are owed to the company on the basis of the Dutch Civil Code ("DCC") and the articles of association of such company and, as can be derived from such duties owed to the company, to the shareholders and the employees of such company. Furthermore, duties are, to some extent, owed by the Managing Directors to certain third parties, in particular creditors and counterparties of the company.

The DCC states, in general wording, that "each Managing Director is required to properly execute the tasks entrusted to him". The DCC does not specifically set out which Managing Director's duties exist under Dutch law. Specific tasks include (amongst others) taking decisions to manage the business, reporting and advising the general meeting of shareholders, keeping financial information up to date, filing annual reports and accounts and representing the company in respect of third parties.

Insolvency considerations for directors

The insolvency considerations that exist for Managing (and Supervisory) Directors would relate to any liability that such Directors might incur. Under Dutch law, the following categories of liability of Managing (and Supervisory) Directors can be distinguished:

Director's liability towards the company

This form of liability results from mismanagement (*onbehoorlijk bestuur*). "Mismanagement" is to be defined as a seriously imputable failure to perform the task entrusted to the Managing Director. Such a claim will have to be instigated by the company, or by the receiver in bankruptcy.

The criteria for establishing mismanagement depends to a large extent on specific circumstances. In general, however, the reproach to be made against the Managing Directors needs to be very serious indeed. In order for a Managing Director to be held liable, he must have acted in a way that no sensible Managing Director would have acted under the same circumstances.

For instance, taking substantial financial risks on behalf of a company is not necessarily considered mismanagement. It is taking unnecessary, or unnecessarily large financial risks that might constitute mismanagement. Conversely, it is not taking great business risks in itself, but doing so without proper preparation or research, or engaging in financial transactions that by far exceed the financial capacities of the company that leads to liability.

The liability for mismanagement is in principle a collective liability; it attaches to all Managing Directors regardless of who actually took part in the improper act or omission. If a matter falls within the field of competence of more than one Managing Director, each of them is jointly and severally liable, except any Managing Director who can prove that the act or omission was not attributable to him and that he did not neglect to take measures to avert the consequences of such act or omission.

Managing Directors are only rarely held liable by the company for mismanagement. Usually the Managing Directors are protected against this form of liability by a discharge concerning the management activities of the preceding year granted by the general meeting of shareholders when it adopts the annual accounts for that year. Such discharge, however, only covers facts that are disclosed in the annual accounts or have been reported to the general meeting of shareholders before the annual accounts were adopted. The (board of) Managing Directors may therefore still be held liable for facts they did not disclose in the annual accounts or in the general meeting preceding the adoption of the annual accounts and the granting of the discharge. Moreover, a discharge granted by the general meeting of shareholders does not prevent the commencement of a claim in bankruptcy (see below).

Supervisory Directors may face liability when they fail to initiate steps against Managing Directors of the company, who are mismanaging, or fail to take measures when the (business of the) company is in disarray.

Directors' liability towards third parties

Annual accounts

Managing Directors are jointly and severally liable for loss suffered by third parties as a result of misrepresentation concerning the company's condition in the annual accounts, Managing Directors' report or interim figures published by the company. A Managing Director can exonerate himself by proving that he was not to blame for the relevant misrepresentation.

If the annual accounts misrepresent the financial condition of the company, the Supervisory Directors are jointly and severally liable with the Managing Directors for any damage suffered by third parties as a result thereof. Again, a Supervisory Director who proves that he was not to blame for any failure in his supervisory duties shall not be liable.

Pre-incorporation contracts

Any person or legal entity acting in the name and on behalf of a company which is in the course of being incorporated will be liable for the performance of any obligations undertaken (unless expressly stipulated otherwise) until the company ratifies the act concerned after its incorporation.

The person or entity concerned will be jointly and severally liable with the company for damage if after ratification of the act by the company, the company is unable to perform its obligations pursuant thereto and the person who contracted on behalf of the company could reasonably have known that the company could not perform such obligations. There is a presumption of knowledge if the company is declared bankrupt within one year of its incorporation.

Registration

After incorporation of a company, its Managing Directors are jointly and severally liable for any legal acts by which the company is bound as long as its paid-up capital does not amount to the minimum share capital prescribed by law, the required minimum proportion of its issued share capital has not been paid up or the company has not been duly registered with the Commercial Register.

Tort

Managing Directors acting within the scope of their management activities may in certain exceptional circumstances also be held liable in tort. Normally, a Managing Director is deemed to act in the context of his regular duties and responsibilities, even if financially detrimental to third parties. In other words, the mere fact that a Managing Director takes action that causes financial harm to third parties is insufficient to create personal liability in tort towards these third parties. Only in circumstances where the Managing Director can be seriously reproached, i.e. where he is personally at fault, will he be exposed to liability.

This, inter alia, is the case where, at the time the company enters into an agreement with a third party, the Managing Director knew (or should have known) that the company would not be able to meet its obligations in due course, and no recourse would be available to compensate for the resulting damages suffered by the other party. Liability in tort could also arise where a Managing Director wilfully prevents the company from performing its obligations towards a third party, when it is otherwise able to do so. Also, financial distributions to shareholders in violation of statutory requirements can lead to personal liability.

Liability following bankruptcy

General

In the event of a company's bankruptcy, the Managing (and Supervisory) Directors will be jointly and severally liable for all debts remaining unpaid after realisation of the company's assets, if they have manifestly neglected to perform their duties properly and this is an important cause (but not necessarily the only cause) of the company's bankruptcy.

"Manifestly neglecting to perform their duties properly" should be interpreted as the making of a serious mistake which goes well beyond the limits of acceptable risk in the ordinary course of the business concerned.

Manifest improper performance is to be proven by the receiver. If, however, the Managing Directors have not complied with their obligations to keep the company's books or to publish the annual accounts on time, they are deemed (without proof of the contrary being allowed) to have neglected to perform their duties properly. In addition, it is then assumed that such inadequacies constitute an important factor and have contributed to the bankruptcy. This is a rebuttable presumption and the Managing Directors may exonerate themselves from personal liability if they can sufficiently demonstrate that an entirely different circumstance was the primary cause of the bankruptcy.

The above-mentioned liability is collectively borne by the Managing Directors. The Managing and Supervisory Directors are jointly and severally liable for management and supervision of the company respectively. A discharge granted by the general meeting of shareholders to the Managing and/or Supervisory Directors does not prevent the commencement of a claim as set out above. However, an individual Managing or Supervisory Director may exonerate himself from this liability by proving that the act or omission was not attributable to him and that he did not neglect to take measures to avert the consequences of such act or omission. Finally, a Managing or Supervisory Director can only be held liable for manifest improper performance made in the period of three years prior to the bankruptcy of the company. For the avoidance of doubt, such period of three years does not apply to liability towards the company (see above in the general part of this section) and liability following tort (see above in tort section).

Liability towards tax and social security authorities

Legislation allows for the personal liability of Managing Directors for certain taxes (i.e. wage withholding tax and value added tax), social security premiums and compulsory pension premiums, in the case of "obvious mismanagement". If the Managing Directors have failed to notify the tax authorities that the company is unable to pay its debts on account of these taxes or premiums, immediately after such inability arises, statute provides that mismanagement is deemed to have occurred. In general, the remarks made regarding liability in the case of a company's bankruptcy apply here (see above).

Lender Liability

A lender could be held liable as a shadow director under Dutch law if it would have to be deemed to have determined company policy as if it were a director. Whilst this is theoretically possible, there is no case law in which a lender is indeed held liable on this ground. This scenario is generally considered unlikely in relation to a bank or other lender.

Exceptional circumstances could give rise to claims by other creditors or by the receiver in the bankruptcy of the company vis-à-vis the lenders, based on tort. Whether or not the lenders' conduct can be qualified as unlawful depends on all circumstances of the case concerned. Based on case law of the Dutch Supreme Court, the lenders' conduct can be regarded as unlawful especially if the lenders have obtained security over all (or a substantial part) of the debtor's assets, have participated in the keeping up of a semblance of creditworthiness of the debtor and have not sufficiently taken into account the interests of other creditors whose recourse possibilities have been diminished or have become illusive as a result thereof.

If the lenders' conduct would fall within the scope of the statutory provisions on voidable preference (see section below), this also could give rise to a claim in tort of the debtor's creditors whose recourse possibilities have been diminished as a result thereof, or to a claim in tort of the receiver in the bankruptcy of the debtor. A claim in tort can be used as an alternative for an action based on voidable preference.

Voidable Preference

Under Dutch law, if certain requirements are met, the receiver (or, outside bankruptcy, any creditor) has the right to nullify a transaction entered into by the insolvent debtor with a third party on the basis of article 42 of the Act: voidable preference (*actio Pauliana*). The consequences of this are that the receiver can take recourse against the relevant assets as if the voided transaction had not taken place, for at most an amount equivalent to the actual disadvantage to other creditors.

Voluntary transactions

The following requirements have to be met to ensure a successful challenge of a transaction entered into by the debtor on a voluntary basis (i.e. in the absence of a legal or contractual obligation):

(a) the transaction was prejudicial to the recourse possibilities of the debtor's creditors; and

(b) both the debtor and its contracting party knew or ought to have known at the time of the transaction that such prejudicial effect would arise. If the debtor receives no consideration for the transaction, only the knowledge of the debtor itself needs to be proven. The Supreme Court has ruled that it is not sufficient for the receiver (or, outside insolvency, any creditor) bringing the *actio Pauliana* to argue that the contracting parties knew or ought to have known of the possibility that the transaction could be prejudicial to the debtor's creditors.

The burden of proof of the above mentioned elements rests upon the receiver, although a reversal in respect of the "knowledge" requirement is provided in law if the voluntary transaction took place less than one year before the debtor was declared bankrupt in respect of certain categories of "suspect" transactions listed in the Act.

Such suspect transactions include, inter alia: (i) transactions by the debtor which are conducted at an "undervalue", (ii) transactions between the debtor and a group company, (iii) transactions between the debtor and a legal entity where the same legal entity holds (directly or indirectly) at least 50% of the issued share capital both in the debtor and the legal entity, and (iv) the paying of or the granting of security for a non-matured debt.

Involuntary transactions (transactions pursuant to a pre-existing statutory or contractual obligation)

On the basis of article 47 of the Act, the receiver also has the power to nullify any transaction performed by the debtor pursuant to a pre-existing statutory or contractual obligation in the event that:

(a) the counterparty knew that a petition for the debtor's bankruptcy had been filed with the court; or

(b) the transaction resulted from concerted action of the debtor and its counterparty aimed at preferring the latter to the detriment of the debtor's other creditors.

"Hardening" period

The power to invoke the *actio Pauliana* as discussed above is not limited to transactions executed within a certain period before the commencement of the bankruptcy proceeding. There is no real "hardening period" for the relevant transactions. Voidable preference has a limitation period of three years from the date on which the receiver discovered the detrimental effect of the transaction.

Recharacterisation/Liability for Debts at Subsidiary Level

Recharacterisation

Intra-group loan transactions are, for civil law purposes, generally not susceptible to recharacterisation. However, payments under such loans by the company may be challenged by the receiver (or, outside bankruptcy, any creditor) in the same manner as discussed in the sections above which consider voidable preference and tort.

Liability for the debts of a subsidiary

General

Normally, a shareholder is not liable for debts of the company in which it holds shares, other than through the paid-up share capital (to the extent not yet paid up) in respect of shares held by it. However, there are exceptions to this principle. Many of the issues dealt with below depend significantly upon factual circumstances.

Specific Issues

Assumed unity

In a situation of assumed unity (*vereenzelviging*), the legal distinction between two separate corporate entities (such as the shareholder of a company and the company itself) will be ignored and the corporate entity and its shareholder will be deemed to be one and the same person. This may result in a sharing of liabilities (i.e. both are liable) and making available the joint assets as objects of recourse (i.e. the assets of both are available for recourse).

If such unity is assumed, liability is necessarily shared. This situation is however rarely held to be applicable. The concept of assumed unity is strictly based on case law. In principle, the creditor will have to show that the corporate identity of a company was abused to the detriment of that creditor or creditors in general.

Breakthrough of liability (piercing the corporate veil)

General

Liability of another entity can also occur without the assumption of unity (set out above). The "sharing of liabilities" is then called "breakthrough of liability" (*doorbraak van aansprakelijkheid*) or "piercing the corporate veil".

A shareholder may be held jointly liable with the debtor-company for (part of) a specific claim of a creditor on such debtor company. Such a breakthrough can occur as a consequence of tort (*onrechtmatige daad*) of the parent company, or on limited other grounds as explained below.

The creditor, in this situation, does not have to prove that the distinction of identity of the companies is abused (see above), but instead has to prove that a tort has been committed. This can be based on, among other things, a "duty of care" on the part of the parent company. This duty of care arises when the parent company is actively involved in (in fact: has taken over) the (financial) management of the subsidiary and the parent company knows or should have known that its involvement with the debtor's management would prejudice creditors' rights. If such (active) involvement is established, and a number of additional conditions are met, liability may exist regarding acts detrimental to the subsidiary's creditors. Additional circumstances could be:

- unreasonably substantial distribution(s) of profits/dividends to the sole shareholder;
- selective payment of the shareholder as a creditor; or
- creating comfort on the part of the creditors or business partners of the company, which causes them to continue delivering goods to the company, which remain unpaid, etc.

A claim against a parent company for debts of a subsidiary would therefore normally involve a claim in tort. Any such liability would co-exist with that of the subsidiary company.

Tort: semblance of creditworthiness

Liability may arise because of the creation by the parent company of an unjustified semblance of creditworthiness of the subsidiary. This could for instance be the case when all (or a substantial part of) assets in the subsidiary have been transferred to itself, thereby making the subsidiary insolvent for any claims from new creditors, who entered into transactions with the company on the basis of that (assumed) creditworthiness. In such cases, liability can be established particularly when the parent company has (i) factual control or the power to intervene and (ii) knew or should have known that the new creditors would be prejudiced because of an absence of recourse.

Tort: asset-stripping

Liability may be established when the parent company has acquired basically all the assets of a subsidiary. Liability can also arise when a company has made irregular dividend distributions or payments to the parent company, when the parent company, based on factual indications, "should have reckoned with the serious possibility that the subsidiary would experience such a shortage that other creditors would be prejudiced".

Set-off

Set-off outside bankruptcy

Outside bankruptcy, two parties that are each others' mutual creditor and debtor can, by means of a declaration to the other party, in principle set off their mutual claims up to the amount which they have in common. The following requirements will then apply:

(a) the parties have to be mutual creditor and debtor to each other;

(b) the claims should correspond to each other (i.e. the debtor should have the right to settle its debt with its claim);

(c) the party invoking set-off is entitled to pay its debt (e.g. the debt has matured or may be prepaid); and

(d) the counter-claim of the party invoking set-off is enforceable.

These requirements, however, are of a non-mandatory nature: parties may agree otherwise.

Set-off in bankruptcy

Under the Act, the creditor of an insolvent debtor may invoke its right of set-off provided that his claim and his debt:

(a) date from before the date of the insolvency; or

(b) result from (one or more) transactions entered into with the insolvent debtor prior to the date of insolvency.

The requirements under (a) or (b) apply to both the claim and the debt. In other words: the cross claims must have pre-insolvency roots. Because the Act presupposes that each creditor of an insolvent debtor may regard his debt as security for the payment of his claim, it may be assumed that all contractual set-off arrangements can be enforced against a receiver, provided that the claim and counter-claim have a pre-insolvency basis. The same applies when the insolvent party is in suspension of payments.

Payments credited to a bank account of the bank's insolvent client after the bankruptcy date do not reduce that client's indebtedness to the bank, unless the bank had a right of pledge over the client's claim *vis-à-vis* a third party, which was paid into the client's bank account. The same applies if the bank, prior to the client's insolvency, knew that the bankruptcy of its client was to be expected at the time of crediting the bank account.

Neither the court nor the receiver is required by law to apply set-off ex officio, i.e. the creditor of the bankrupt company is required to invoke set-off itself in order for set-off to operate.

Recognition of Foreign Insolvency Proceedings

Within the scope of the EU Insolvency Regulation

Under the Regulation recognition in the Netherlands of foreign insolvency proceedings (listed in the Regulation) would be automatic.

Outside the scope of the EU Insolvency Regulation

To what extent foreign insolvency proceedings of debtors incorporated outside the European Union (or in Denmark) are recognised in The Netherlands, is unclear. It appears from Supreme Court case law, save international treaty provisions to the contrary, that foreign insolvency proceedings, in principle, only have territorial effect.

This means, first of all, that the foreign general attachment of the insolvent debtor's assets (or similar effects, such as the transfer of the estate to a receiver in bankruptcy) does not include the assets of the debtor that are situated in The Netherlands. Furthermore, in principle the legal effects of insolvency proceedings commenced under foreign insolvency laws cannot be invoked in The Netherlands.

Although international insolvency law of The Netherlands is based on the territorial effect of foreign insolvency proceedings, this does not mean that these proceedings do not receive any recognition at all. The foreign receiver has *locus standi* in The Netherlands.

The powers granted to a liquidator by the foreign *lex concursus* should therefore in principle be recognised in The Netherlands. Also in other respects foreign insolvencies can have legal consequences in The Netherlands.

It could be argued that the legal consequences created by the foreign insolvency law can be recognised in The Netherlands, as long as (i) they are not closely connected with the fact that the foreign insolvency must be regarded as a general attachment on the insolvent debtor's assets for the benefit of all his creditors, and (ii) this does not lead to unsatisfied creditors no longer having recourse in respect of assets of the insolvent debtor that are situated in The Netherlands.

One of the main principles of international insolvency law of The Netherlands is that, as far as insolvency proceedings commenced in The Netherlands are concerned, The Netherlands proceedings have "universal effect", which (*inter alia*) means that they aspire to comprise all assets of the insolvent debtor, including those situated abroad.

Poland

Key Elements:

- Single bankruptcy proceeding
- Separate recovery proceeding
- Ranking of claims
- Directors' duties
- Antecedent transactions

Insolvency Regimes

Under the Bankruptcy and Recovery Law dated 28 February 2003 there is a single bankruptcy proceeding (postepowanie upadlosciowe) carried out by the court, whereby two insolvency options are available: (i) the liquidation of the bankrupt estate and pro rata distribution of proceeds to the creditors pursuant to the statutory order of priority of claims, or (ii) preserving the debtor's business through a composition arrangement, which is subject to creditors' approval in a vote and final approval by the court.

In addition, there is a separate recovery proceeding (postepowanie naprawcze). The procedure is simplified and is basically carried out by the debtor itself (out-of-court, although subject to certain controlling powers of the court). Its aim is to provide a framework for the debtor to reach a composition arrangement with its creditors.

Starting from 31 March 2009 not only an "entrepreneur" (i.e. a natural person, legal person or partnership, which in its own name carries out business activity) but also a consumer (i.e. a natural person not carrying out business activity) can be declared bankrupt. An entrepreneur is obliged to file a petition for the commencement of bankruptcy proceedings within two weeks of the date that a reason for its bankruptcy declaration occurred (i.e., either the solvency test or the balance sheet test was passed). The same duty applies to each representative of a debtor who is a legal person or an entity having legal capacity without being a legal person. A consumer may apply for bankruptcy only if he/she became insolvent due to exceptional circumstances out of the consumer's control.

The recovery proceeding is optional, i.e. the debtor who anticipates its insolvency in the future but still remains solvent has the right (but not a duty) to commence the proceedings.

Recent amendments to the Bankruptcy and Recovery Law

The Bankruptcy and Recovery Law has been recently amended. The amendments entered into force on 2 May 2009. The most important changes include the following:

(i) the liquidity test now refers to pecuniary obligations only (before it related to non-pecuniary claims as well);

(ii) the unsecured claims to be satisfied out of the proceeds of liquidation are grouped into five categories (i.e. one more group has been created);

(iii) composition now affects secured claims to the extent that the claims are not covered by the value of collateral, or the relevant secured creditor agrees to be affected by the composition;

(iv) for the purposes of voting on composition proposals, the judge commissioner is able to refrain from dividing creditors into groups. In this case, the terms of the proposed composition are the same for all creditors (unless a creditor agrees to less favourable terms) and the composition is deemed accepted if voted for by a majority of creditors having together at least two-thirds of the total amount of claims authorised to vote. If the creditors are divided into groups, the composition is deemed to be accepted if voted for by the majority of creditors in each group having at least two-thirds of the total amount of claims authorised to vote in that group. However, the composition can be "crammed down" (i.e. is deemed concluded if there is no required majority in one or more of the groups of creditors), provided that: (i) a majority of creditors from each of the other groups having two-thirds of the total amount of claims authorised to vote have accepted the composition, and the creditors from the dissenting group(s) would be satisfied through the composition to an extent which is not less favourable than in the case of liquidation;

(v) recovery proceedings are available also for insolvent debtors whose debts do not exceed 10% of the overall value of the assets and are overdue for not more than three months;

(vi) a security assignment and security transfer of ownership are treated the same as pledges (at the moment, assets encumbered with these forms of security are effectively excluded from the bankruptcy estate).

Test for Insolvency

Liquidity test

The insolvency test is passed if the debtor does not perform its pecuniary obligations as they fall due. Arguably a short-term suspension of payment of debts as a result of temporary difficulties is not a sufficient basis for the declaration of bankruptcy. The debtor should be declared bankruptcy if it fails to settle most of its liabilities over a longer period of time.

Balance sheet test

The balance sheet test is passed if the debtor's total obligations exceed the value of total assets (even if the obligations are being performed on a timely basis).

To become "insolvent", a corporate debtor must satisfy either the (i) liquidity test; or (ii) the balance sheet test. With respect to other debtors (especially, sole traders and consumers), only the liquidity test applies.

Bankruptcy Proceedings

Bankruptcy proceedings in relation to an entrepreneur are initiated either voluntarily (i.e. through filing by the debtor) or involuntarily (i.e. through filing by any creditor). The court decides after a hearing whether the tests for commencement (described above) have been met. A petitioning debtor must, and a petitioning creditor can, indicate in the bankruptcy petition whether it applies for bankruptcy with a composition option or liquidation.

If it is sufficiently substantiated that through the composition the creditors would be satisfied to a greater extent than in the case of liquidation, the court will declare bankruptcy with a composition option. However, the composition option will not be allowed if, due to the debtor's behaviour to date, there is no certainty that the composition will be achieved (unless the composition proposals provide for a liquidation plan). In addition, if an initial creditors' meeting was convened and adopted a resolution as to the method of conducting the proceedings (i.e. composition or liquidation), the court should respect such resolution unless it is contrary to the law.

During the proceedings the court is able to change its original decision in respect of the applicable bankruptcy option and accordingly switch from the composition option to liquidation or vice versa. Such a decision can only be made if grounds justifying the alternative option have become apparent in the course of the proceedings.

Recovery Proceedings

It is the debtor (and not the court) who commences the recovery proceedings by way of notice filed with the court. Therefore, creditors and shareholders do not have the right to apply for the opening of recovery proceedings.

The debtor's notice of commencement of the proceedings should contain administrative details regarding the debtor and should indicate and substantiate circumstances justifying the notice. The notice should be attached with a recovery plan.

The court may prohibit the proceedings from being commenced within fourteen days of the debtor's filing. The court can only prohibit recovery proceedings if the statutory conditions for the commencement are not met, the notice of commencement or attachments do not comply with applicable requirements, or the representations or information set out in the documents filed is not true.

Moratorium

A moratorium applies in relation to each of the aforementioned insolvency regimes. However, the bankruptcy with a composition option does not affect the rights of secured creditors who can enforce their security interest to satisfy secured claims. The court may temporarily suspend the enforcement, but for not more than three months.

Priorities

Priority of unsecured claims

Unsecured claims are grouped into five categories to be satisfied out of the proceeds of liquidation in the following order:

(i) costs of bankruptcy proceedings; the following claims due after the declaration of bankruptcy: alimony claims, pensions due as compensation for causing a disease, inability to work, disability or death and claims due as a result of the conversion of life usufruct into life annuity; claims stemming from unjust enrichment of the bankrupt estate; claims under executory contracts whose performance was demanded by the bankruptcy officer; claims originated by the acts of the bankruptcy officer; claims generated by the bankrupt's acts for which the court supervisor's permission was not necessary or carried out with the court supervisor's permission;

(ii) the following claims due before the declaration of bankruptcy: employment claims, farmers' claims under contracts of delivery of products from their own farm, alimony claims, pensions due as compensation for causing a disease, inability to work, disability or death and claims due as a result of the conversion of life usufruct into life annuity; social insurance contributions payable on behalf of employees (together with interest and costs of execution) for the last two years prior to the bankruptcy;

(iii) tax liabilities, other public charges and other social insurance contributions, together with interest and costs of execution;

(iv) other claims that do not fall into the fifth category, together with interest for the year preceding the declaration of bankruptcy, together with contractual damages, costs of litigation and execution; and

(v) interest that does not fall into the higher categories (to be paid out in the order in which the principal sums should be satisfied); fines imposed by the courts and administrative authorities; claims in respect of donations and legacies.

A claim (receivable) against the debtor acquired by way of assignment or endorsement after the declaration of bankruptcy will be satisfied under the third category, unless it is to be satisfied in the fourth category. This does not apply to claims resulting from acts of the bankruptcy officer or acts of the bankrupt carried out with the court supervisor's permission.

Secured Creditors

Claims secured in rem, i.e. by way of mortgage, pledge, registered pledge, treasury pledge and maritime mortgage, are dealt with separately from unsecured claims. The Bankruptcy and Recovery Law does not give a secured creditor control over the realisation of the encumbered assets, but it does adopt a clear and sensible approach to realisations. It provides for a separate distribution of proceeds realised from the sale of the encumbered assets. The sale proceeds, after deduction of the costs of sale and capped costs of the bankruptcy proceedings, are distributed to the secured creditors according to their respective priorities. But, in the case of security over real property or ships (mortgage), the following claims will have priority over the mortgagee's claim: (i) alimony claims due after the declaration of bankruptcy; (ii) claims of the employees who performed their work on the real property or ship for the last 3 months preceding the sale (but not more than three times the minimum guaranteed salary); and (iii) pensions due as compensation for causing a disease, injury or death as well as annuities resulting from the conversion of life usufruct into life annuity, due after the declaration of bankruptcy.

Where an asset (a moveable, a receivable or a property right, or a collection thereof) has been encumbered with a registered pledge comprising a contractual option to satisfy the secured claim by taking-over the encumbered asset or by way of its sale, the pledgee will still be able to exercise these contractual options (subject to certain exceptions). Accordingly, such assets will be liquidated, at the pledgee's option, through the pledgee taking over title to the assets or through a sale.

Security assignment and security transfer of ownership are treated the same as pledges and the secured creditors have no right to claim the encumbered assets to be excluded from the bankruptcy estate.

If the proceeds of liquidation of encumbered assets are not sufficient to satisfy the relevant secured claims in full, the remaining portion of the secured claims will be satisfied pari passu with unsecured claims from liquidation of the bankrupt estate.

Creditors who hold claims secured on the debtor's assets located abroad by way of mortgage or entry in a register cannot participate in bankruptcy distributions. Such claims will be allowed only if the creditor submits evidence that foreign security has been de-registered (released).

Directors

Under Polish law, fiduciary duties are imposed only on de jure directors, i.e. (in the case of companies) members of the management board. De facto directors (i.e. those to whom certain management powers are delegated) will be responsible only within the scope of their contract with the company (usually, framed as employment contract). The concept of "shadow directors" is not recognised by Polish law, although one cannot exclude that a person who indeed controls the managers of the company may be held liable for damages it has caused, based on the principle of fault.

In relation to the duty to file a bankruptcy petition, the Bankruptcy and Recovery Law sets out a list of persons obliged to do it, e.g. with regard to legal persons and other organisational entities -it is any person authorised to represent them individually or jointly with other persons; with regard to partnerships -it is any partner; with regard to an entity being subject to non-bankrupt liquidation -it is any liquidator. The duty to file a petition applies to each representative of a debtor who is a legal person or an entity having legal capacity without being a legal person. For companies, this applies to each member of the management board (i.e. de jure directors).

Management duties and potential liabilities

Members of the management board owe fiduciary duties to the company itself and can be held liable to it for either breach of law or the company's charter. They can also become liable to the shareholders and third parties (contractors, suppliers, employees, etc.) based on the principle of fault (which is present not only if there is an actual intent to cause harm but also in the case of negligence). In certain circumstances, members of the management board can also be subject to criminal liability.

If the members of the management board fail to file the petition for a bankruptcy, contrary to the duty to do so, then they are liable to the creditors for any damages incurred by their failure to file. In limited liability companies, their liability goes even further as they are also liable for all debts of the company if enforcement against the company's assets has proven unsuccessful. However, in this case the members of the management board can be partly released from liability, to the extent that the relevant creditor would not be satisfied even if the bankruptcy petition was filed on a timely basis. Furthermore, they may also be subject to criminal liability (imprisonment for up to 1 year) and be deprived of the right to run a business, act as a representative of entrepreneurs and/or sit on the supervisory boards of companies and co-operatives.

Under Polish law, members of the management board have only statutory duties (stemming from generally applicable laws) and contractual duties (stemming from the relevant contract under which they perform the duties).

Insolvency issues for directors

Wrongful or fraudulent trading triggers

civil liability and, in certain circumstances, may also lead to criminal liability. If such facts are established, the court will not allow the management board to keep control over the assets as a "debtor in possession" even if the tests for composition are substantiated. Following the declaration of bankruptcy, the bankruptcy officer will be able to take an action for compensation against them if, as a result of wrongful or fraudulent trading, the company has suffered damage.

The directors are criminally liable for transactions considered commercially reckless and leading to bankruptcy, as well as for preferential treatment of certain creditors in the event of an upcoming bankruptcy. Notably, for the purposes of the balance sheet test, one should take into account not only mature obligations but also known and/or foreseeable future obligations.

Lender Liability

The notion of lenders' liability for the borrower's debts (construed on the basis of "shadow director" or similar concepts) has not been recognised in the legislation, legal doctrine or court practice in Poland. A lender who controls and directs the debtor's business can be found liable for the debtor's debts based on the general principle of fault. To date, the concept of controlling/directing lenders' liability for the borrower's debts has never been successfully claimed in Poland.

Creditor Grouping

Voting procedure applies to a number of decisions, but the two most important are the determination of applicable mode of the proceedings (liquidation or composition) and, in the case of composition, the approval of the composition plan. For the purpose of voting on the composition plan, the judge-commissioner may classify the creditors into the following groups: (i) employment, (ii) claims secured in rem; (iii) creditors who are shareholders; and (iv) other claims (which may be split into further groups). The judge-commissioner is, however, able to refrain from dividing creditors into groups.

If the creditors are not grouped, the terms of the proposed composition should be the same for all creditors (unless a creditor agrees to less favourable terms) and the composition is deemed accepted if voted for by the majority of creditors jointly holding at least two-thirds of the total amount of claims authorised to vote.

If the creditors are grouped, the composition is deemed to be accepted if voted for by the majority of creditors in each group having at least two-thirds of the total amount of claims authorised to vote in that group. However, the composition can be "crammed down" (i.e. is deemed concluded if there is no required majority in one or more of the groups of creditors), provided that: (i) the majority of creditors from each of the other groups having two-thirds of the total amount of claims authorised to vote have accepted the composition, and (ii) the creditors from the dissenting group(s) would be satisfied through the composition to an extent which is not less favourable than in the case of liquidation.

The composition binds all creditors whose claims are subject to composition, save for those whose claims have been deliberately kept undisclosed by the debtor and who have not participated in the proceedings.

Dissenting creditors can appeal against the court decision approving the composition. The appeal can be based on either procedural or substantive grounds; the most significant objection being that the composition is not compliant with the law (but, notably, the law does not limit the scope of available workouts, provided that their terms must be identical in relation to each creditor in the same group) or that its terms are blatantly detrimental to creditors who voted against it and filed pleas.

The aforementioned bankruptcy proceedings aim to enhance the preservation of companies, therefore the courts are often quite favourable to the debtors. However, the position of creditors has been significantly improved under the Bankruptcy and Recovery Law in comparison to the previous regime. For example, an initial creditors' meeting may choose the method of conducting the proceeding (i.e. composition or bankruptcy) and this choice is binding upon the court. The creditors can also impose their own composition plan (which may even comprise a liquidation plan) on the debtor.

Antecedent Transactions

All gratuitous transactions performed by the debtor within one year before the bankruptcy filing are ineffective. The same applies to transactions where a value received by the debtor is considerably less than the value of the debtor's performance, i.e. transactions at an undervalue. Because the provisions of Bankruptcy and Recovery Law do not provide for a definition of the "transactions at an undervalue", the transaction should be evaluated with a consideration of the arm's length principle.

The repayment of a debt prior to its maturity date or the establishment of a security interest in order to secure such a debt will not be effective, if made within two months preceding the day of the bankruptcy filing. The creditor may request that the repayment or the provision of security be declared effective on the basis that he had no knowledge about the existence of grounds for the declaration of bankruptcy.

Transactions with related parties (relatives or affiliated companies) are ineffective if made within six months before the bankruptcy filing (even if made at arms length and on fair market terms).

The judge-commissioner may also declare as ineffective the establishment by the debtor of a security interest in rem (including pledge and mortgage) as security for a third party's debt if the debtor has obtained in return no value or inadequate value. Irrespective of the value received, the judge-commissioner will declare ineffective any security interest to secure a debt of a related party. In these cases, the "hardening" period is one year.

The bankruptcy officer may also file an action with the civil court in order to declare any other transaction ineffective if it was made to the creditor's detriment, based on the general "actio Pauliana" (in which case the "hardening" period can be up to five years). A transaction will be declared ineffective on this basis if:

(i) the transaction was detrimental to creditors, i.e. the debtor, as a result of the transaction, became insolvent (or, if it was already insolvent, became insolvent to a greater extent);

(ii) the debtor was aware of the detrimental effect on the position of creditors; and

(iii) the other contracting party was aware of the detrimental effect or, acting diligently, could have become aware of the detrimental effect (awareness is presumed if the contracting party was in a close commercial relationship with the debtor).

In general, all transactions concluded within a hardening period described above are captured by the relevant hardening periods notwithstanding the debtor's intention.

There are two exceptions. Firstly, if the debt was repaid prior to its maturity date, or security was given to secure immature debt, the creditor may rebut the challenge if it proves that at the moment of accepting the repayment or security he was not aware of the existence of the grounds for a declaration of bankruptcy. Secondly, with regard to "actio Pauliana" described above, the creditor may also rebut the challenge if the creditor can prove that they could not have become aware of the detrimental effect.

Recharacterisation

A shareholder's claim in respect of a loan granted to its subsidiary company shall be treated as a contribution to the company's share capital if the company is declared bankrupt within two years of the date the loan agreement being entered into.

All transactions with related parties are ineffective if made within six months before the bankruptcy filing (irrespective of whether any value was provided).

The parent company cannot be liable for the debts of a subsidiary.

Set-off

Set-off is inadmissible if the creditor has acquired its claim by way of assignment or endorsement after the declaration of bankruptcy or within the last year preceding the declaration of bankruptcy if such creditor knew of reasons, which may have led to the eventual bankruptcy.

In the case of bankruptcy with the composition option, as long as the proceedings are not discontinued, completed or switched to the liquidation option, set-off is inadmissible if the creditor has become the bankrupt's debtor after the declaration of bankruptcy, or (while being the bankrupt's debtor) has acquired a claim against the bankrupt by way of assignment or endorsement after the declaration of bankruptcy. However, this limitation does not apply if the creditor has acquired the claim as a result of subrogation, i.e. by way of paying off the bankrupt's debt for which it had been personally liable (e.g. as guarantor) or with certain assets (e.g. as pledgee), provided that the liability for the bankrupt's debt originated before an application for bankruptcy was filed.

A creditor who wishes to exercise the right of set-off must make a declaration to that effect no later than at the point of filing of its proof of claim and such declaration should be attached thereto.

In the case of bankruptcy with the liquidation option, set-off is possible only if both debts existed at the time of declaration of bankruptcy, even if payment of one of them was not due. The creditor's debt will be fixed at the aggregate amount whereas the bankrupt's debt will be fixed as the principal sum with no interest as from the date of declaration of bankruptcy.

If the bankrupt's non-interest-bearing debt did not fall due on the date of declaration of bankruptcy, the amount to be set-off will be the sum reduced by statutory interest (at a rate not exceeding six per cent per annum), running from the date of declaration of bankruptcy until the payment date, but not for more than two years.

Recognition of Foreign Insolvency Proceedings

The comments below do not apply to insolvencies within the EU, which are recognised pursuant to the Regulation.

The Bankruptcy and Recovery Law deals with the recognition of foreign insolvency proceedings in line with the UNCITRAL Model Law on Cross-Border Insolvency.

The recognition of foreign insolvency proceedings does not prevent the Polish court from opening parallel bankruptcy proceedings in Poland (provided that if the foreign insolvency proceedings are recognised as the main proceedings, the proceedings in Poland will have the status of secondary proceedings and can relate only to the debtor's assets located in Poland).

The debtor does not have to run a business in Poland in order to be eligible for bankruptcy proceedings. It is sufficient if the debtor's assets (not necessarily organised as an enterprise) are located in Poland. The debtor must possess bankruptcy capacity, i.e. must be capable of acting in a court proceeding and be an "entrepreneur" within the meaning ascribed to this term by the Bankruptcy and Recovery Law.

Polish Courts will recognise only those foreign proceedings that meet the statutory definition, which covers "any court or administrative proceedings carried out abroad the subject of which is joint enforcement of claims against an insolvent debtor, where the assets and matters of the debtor are surrendered to the control or management of a foreign court for the purpose of their restructuring or liquidation".

Recognition proceedings can only be instigated upon a motion by a foreign administrator. The Polish court will issue an order on the recognition if the Polish courts have no exclusive jurisdiction, the recognition would not conflict with the basic principles of legal order in Poland, and the motion for recognition meets formal requirements. The order on recognition will indicate whether the recognised proceedings are main or secondary proceedings.

The recognition of foreign insolvency proceedings comprises the recognition of decisions relating to the appointment, dismissal and change of an administrator, and decisions relating to the conduct of the foreign proceedings, their suspension or completion. Furthermore, the Polish court can also decide on the enforceability in Poland of foreign executory documents issued in the course of the foreign proceedings (e.g. a list of claims, a composition or similar documents), provided that such executory documents are enforceable in the state where they were issued and relate to a matter that is not subject to the exclusive jurisdiction of the Polish courts, and their enforcement would not conflict with the basic principles of legal order in Poland.

On the day of recognition, by operation of law the court actions relating to the debtor's assets are stayed, and the debtor is deprived of the right to manage and dispose of its assets (unless the recognised proceedings contemplate a composition and the debtor has retained possession of its assets).

The effects of any bankruptcy declaration issued abroad and recognised in Poland as to the assets located in Poland and as to the obligations that have originated or are to be performed in Poland, are subject to Polish law. In addition, the ineffectiveness and avoidance of the debtor's transactions relating to the assets located in Poland will also be subject to Polish law.

The Czech Republic

Key Elements:

- Reorganisation procedures available since January 2008
- Increase in creditor control
- Automatic stay applies
- Set-off is allowed subject to limitations
- Netting arrangements work

Introduction

As of 1 January 2008, the Czech Republic completely overhauled its insolvency law, replacing its Bankruptcy and Composition Act of 1991 with a new Insolvency Act (Act No.182/2006 Coll., the "IA"). The legislative process leading to the new codification was long and difficult, but one can say with a reasonable degree of confidence that, quibbles aside, it has resulted in a modern insolvency law regime for corporate debtors. The IA also introduces discharge proceedings available to not-for-profit organisations and individuals but this area of the law, although interesting, is beyond the scope of this publication. In July 2009, the IA underwent the first set of substantive amendments (promulgated as Act No. 217/2009 Coll., the "2009 Amendments"), aimed at easing the impact of the economic downturn on businesses and households. In March 2011, the IA was amended in response to a Constitutional Court judgment from July 2010 which found certain provisions regulating the allowance/contestation of claims wanting in constitutional terms.

Insolvency and Restructuring Processes

Under the IA, there are two main types of proceedings available to corporate debtors: liquidation (konkurs), i.e. a sale of the estate (piecemeal or as a going-concern) with satisfaction of creditors through distribution of the proceeds, and reorganisation (reorganizace), i.e. a non-liquidation reorganisation measure, typically a re-capitalisation, based on a reorganisation plan approved by creditors and the court.

In theory, the proceedings under the Insolvency Act start as unitary with a general phase meant to determine insolvency and the method of its resolution (i.e. liquidation or reorganisation). In actual fact, the majority of corporate debtors will proceed straight into liquidation, upon court determination of their insolvency. This is because reorganisation (unless pre-approved by the majority of secured and unsecured creditors) is available only to debtors who meet a certain threshold, being either minimum annual sales of CZK 100m (approximately €4m) or minimum staff of 100 full-time employees. Based on data on the debtor population under the previous bankruptcy regime in the years 1991 to 2004, this would apply to 8-9% of all debtors. In the years 2008, 2009 and 2010, 39 reorganisation attempts have been allowed. Although the IA specifically allows pre-packaged reorganization plans (i.e. those already approved by a substantial majority of creditors) to be filed, none of the debtors have so far taken advantage of this route.

An important procedural change was introduced by the 2009 Amendments with respect to proceedings relating to groups of companies. As a rule, the insolvency court must now appoint the same trustee for all debtors who belong to the same corporate group. In connection with the previous rule, if such appointment results in potential conflict between the affiliated companies, the court will appoint a separate ad hoc trustee to deal with the particular conflicting situation. A related amendment to the Act on Courts and Judges will achieved the concentration of insolvency cases of debtors belonging to the same corporate group before the same insolvency judge.

Liquidation

In liquidation, a trustee will displace management, gather the assets, list and verify liabilities (both subject to the possible adjustment via adversary proceedings where ownership of assets or amount or rank of claims is disputed), convert the assets into cash through a sale (piecemeal or going concern) and distribute the cash to creditors in an order of priorities that follows, subject to certain exemptions, the ranking of claims under non-insolvency law. Several significant liquidation going-concern sales have taken place since the IA came into force.

Reorganisation

The reorganisation provisions were heavily inspired by Chapter 11 of the U.S. Bankruptcy Code, but with significant departures from this model especially as regards the entry into reorganisation (see the "threshold test" above and the creditors' right to determine the type of proceedings, described further below in this section).

In reorganisation, the debtor's management will remain in control, being monitored by a trustee and a creditors' committee and will, upon the court allowing a reorganisation attempt through an initial ruling, propose and negotiate a plan, while the company's business continues. Shareholders will be stripped of their voting control with one exception -they will keep the right to elect the management. Creditors will be able to pre-empt the court's decision on whether a reorganisation attempt should be allowed through a vote, however, such decision must be approved either by a significant majority across classes (90% of all claims present or represented) or by both secured and unsecured creditors voting separately (in each of these groups through a simple majority of claims present or represented). If creditors decide that the debtor's business should be liquidated, the court will convert the proceedings into liquidation, in spite of the debtor meeting the size test, described above. If the creditors agree with the reorganisation plan (or, in relation to a debtor who meets the size test, do not agree but fail to obtain the requisite majority of votes against the debtor's proposal), the court will allow a reorganisation attempt if it is satisfied that reorganisation is proposed in good faith.

This decision will have to be taken within three months of the debtor being declared insolvent by the court. Management will then have an exclusivity period of 120 days to submit a proposal of a plan to the court, together with a disclosure report. The courts may extend the deadline for plan submission by up to another 120 days and empirical data shows that they readily do so and that plans tend to be submitted during the extended term). Upon the court's approval of the report, but not earlier than after 15 days from the report being published, a creditors' meeting will vote on the plan. The plan may propose any lawful measure of resolution of the company's insolvency -the IA allows flexibility in this respect. Creditors will vote on the plan by classes; a majority in the number of creditors and by amount of claims in each class is needed for the plan to be approved. Creditors will be placed in classes according to criteria proposed in the plan, however, each secured creditor will always be in a class of its own, as will be the company's shareholders.

Creditors whose claims are not affected by the plan will be deemed to have approved the plan. As regards classification of other claims, claims grouped in any one class must be substantially the same as regards their legal rights and their commercial nature. A plan approved by all classes will be confirmed by the court subject to several tests, most importantly legality and good faith, and minimum pay-out test on individual rather than class basis (in U.S. bankruptcy law, this would be called the "best interest" test), being the likely pay-out in a liquidation.

The court may also confirm a plan not approved by all classes (the so-called "cram-down") but only if at least one affected class distinct from the shareholders voted in favour of the plan and if the plan (i) leaves the security interests of secured creditors substantially unaltered and pays to secured creditors the net present value of their collateral, as determined by an expert valuer, and (ii) adheres to the "absolute priority rule" with respect to other classes, meaning that the opposing unsecured creditor class must either be paid in full or no class junior to its claims may receive any pay out under the plan, which may entail wiping out the current equity and replacing it with new registered capital.

Upon confirmation, the pre-confirmation claims will be extinguished and replaced by new claims as determined in the plan. Also, assets will be freed from pre-confirmation encumbrances. The proceedings will not be terminated upon confirmation. They move into the "performance" phase in which management will remain in control but will still be monitored by the trustee and the creditors' committee. If the plan is performed as confirmed, the court will close the proceedings. If the plan is not performed the court will convert the proceedings into liquidation where creditors claims are at the level previously agreed in the plan.

The 2009 Amendments changed several rules directly related to reorganisation. Firstly, the pre-approval requirements for the filing of a pre-packaged plan (i.e. a plan pre-agreed between the debtor and the creditors in order to accelerate the proceedings by effectively merging the court's order finding the company insolvent with its order allowing an reorganisation attempt) have been eased. Instead of the approval of all creditor classes required previously, the 2009 Amendments only require the approval by the majority of claims of secured and unsecured creditors. Secondly, the 2009 Amendments also allow creditors to take away the debtor's exclusive right to propose a reorganization plan. Interestingly, this decision can be taken by the vote of a simple majority of claims present or represented, without any distinction between secured and unsecured creditors. Finally, the 2009 Amendments banned set-off during reorganisation proceedings (see more under "Set-off" below).

Impact on Third Party Rights

An insolvency petition will be registered by the insolvency court and published in an on-line publicly accessible insolvency register within two hours of the filing. Upon the publication, the enforcement of creditors claims (secured as well as unsecured) becomes subject to an automatic stay. In liquidation, the stay is de facto limited through a rule that allows the secured creditor to issue instructions to the insolvency trustee as regards the realisation of the collateral.

The court may reverse these instructions only where they would prejudice the common interest of all creditors on the highest possible realisation of the estate. In reorganisation, enforcement of creditors claims (including secured creditors claims) will be subject to the stay throughout the reorganisation proceedings. The mitigating factors are the creditors' right to preclude a reorganisation attempt and take away the debtor's exclusive right to propose a plan (as explained above) and the debtor's obligation to pay interest to the secured creditors at contract rate from the value of their collateral as determined by an external valuer. A failure to meet these payments would mean a conversion to liquidation.

Unlike in some other jurisdictions, the automatic stay does not extend to shield executory contracts from termination by the debtor's counterparty. These are subject to (rather unclear) rules in liquidation -essentially, the trustee will be able to assume or reject an executory contract but if he does neither within 15 days from the court's decision that the proceedings will be liquidation proceedings, the contract will be deemed to be rejected. The main difficulty with this rule, in addition to the inadequate length of the period given to the trustee, is the fact that the IA effects rejection on a rescission only basis which, under Czech law, puts the parties back in their original position.

The counterparty's claim for rescission will rank as an administrative priority claim. This solution is very disruptive (not least to general pre-commencement creditors who will be subordinated to this claim) and seems out of line with rules dealing with executory contracts in other jurisdictions. In reorganisation, executory contracts are arguably not regulated at all, although the IA contains a provision that could possibly be interpreted as a prohibition of ipso facto clauses. The law in relation to executory contracts is arguably the least successful part of the IA and one must hope that the legislator will address these issues in the near future.

Priority Ranking of Creditors

Until March 2011, only the trustee and the debtor - but not creditors - could challenge creditors' proofs of claim. As a result of an intervention by the Constitutional Court, the IA was amended such that in proceedings in which an insolvency order was handed down after 31 March 2011, creditors will be entitled to challenge each others' claims, subject to various checks and limitations aimed at controlling the risk of abuse of that right.

As before, creditors who file inflated claims face the risk of being penalised financially and having their claims disregarded in the proceedings.

With certain exceptions, the IA respects the ranking of claims under pre-insolvency law, i.e. it respects both the priority of secured claims and the subordination of junior claims.

With respect to secured claims, the priority is absolute in liquidation, save for capped deductions for the costs of maintenance and sale of the collateral (these should not amount to more than 9 or (depending on the reading of the law) 11% of the gross proceeds of the realisation of the collateral. In a reorganisation, secured creditors may, under certain circumstances, have to suffer a dilution as a consequence of post-commencement finance claims which may rank pari passu with pre-commencement secured claims. But this would only be so where (i) the post-commencement financing was provided following the court's approval of the reorganisation attempt and in furtherance of the goals of the reorganisation, (ii) the relevant financing contract was approved by the creditors committee and (iii) the secured creditor did not make use of the right of first refusal, granted by the IA, to provide the post-commencement financing itself.

Unsecured claims will be subject to secured pre-commencement claims, administrative (i.e. post-commencement) claims as well as certain preferred pre-commencement claims, most notably unpaid wages and other employee claims back and to personal injury claims.

Subordinated claims will be paid subject to the terms of their contractual subordination. The IA did not introduce equitable subordination of shareholder or other connected party claims.

Directors' Duties

These can be grouped into duties relating to the opening of the proceedings and duties that directors have in the proceedings where they remain in control.

The former duties mainly include the directors' duty to file for the commencement of proceedings without delay after the directors have determined, or should have determined, that the company is insolvent. Insolvency is tested both on the cash-flow basis (i.e. the company's ability to meet current debts) and the balance sheet (i.e. the market value of the company's assets against the total amount of its liabilities). This duty is subject to very stringent liability for damages -directors who are in default of the duty will be liable to creditors for damages whose amount will be presumed to be equal to the difference between their proven claims and the insolvency dividend. Importantly, chiefly out of concern that the prevailing asset price volatility and uncertainty of valuations may force debtors to file for insolvency even in cases where the filing would be unsubstantiated in times of more stable asset valuations, the 2009 Amendments removed the debtor's (and directors') duty to file on the grounds of the balance sheet test. However, this relaxation is temporary -the rule will revert to its original wording at the end of 2011.

The latter duties can be described as the fiduciary duties to the creditors similar to those applicable to the insolvency trustee. The directors who remain in control of the company will have to act diligently and will be obliged to put the creditors' interests first.

Lender Liability

As a matter of fact, lender liability law does not exist in the Czech Republic but there are statutory provisions (most notably rules on shadow directorship and groups of companies) which could be used to make a creditor who substantially influences the company's actions liable to the company and indirectly its shareholders. Currently, an attempt to strip a major bank creditor of its votes in insolvency proceedings (*in re Od vní podnik*) on allegations of the bank's pre-insolvency conduct is being fiercely litigated. The proceedings have been tarnished by a number of irregularities on the part of the insolvency court and it is currently too early to say whether they will have any impact on law development in this area.

Challenging Antecedent Transactions

The IA allows the insolvency trustee (but not the debtor's management) to sue in order to avoid antecedent transactions that can be shown to constitute a preference, an undervalue or a transfer with actual fraudulent intent. The trustee may bring the action within one year from the opening of insolvency proceedings. The standard claw-back period is one year for preferences and undervalues and five years for transactions with actual fraudulent intent. For preferences and undervalues, the trustee must show that the debtor was either insolvent or became insolvent as the result of the transaction. For transactions with connected parties, the claw-back period for preferences and undervalues is extended to three years and the debtor's insolvency will be presumed.

Set-off

The IA has substantially liberalised insolvent set-off which was fully precluded under the previous Bankruptcy and Composition Act. Under the IA in its original version, a creditor could set off its mutual claims vis-à-vis the debtor provided that the substantive conditions for the set-off were met prior to the date of determination of the type of bankruptcy proceedings. For all practical purposes, this means that a creditor was entitled to off set pre-commencement claims although a creditor must formally prove its claim and pay any net sums due to the debtor. Also, a creditor was not entitled to the set-off if he knew of the debtor's insolvency when he acquired his claim.

The 2009 Amendments tightened the rules on set-off significantly. They banned set-off after a court order declaring a moratorium (a special protective measure which the court may, with the approval of majority of creditors' claims, order for up to 3 months prior to, or following, the opening of the proceedings) and after the filing of an application for reorganisation. The insolvency court is entitled to grant exemptions from the ban. Furthermore, upon the application by a party in interest and where this is not contrary to the common interest of creditors, the insolvency court has the power to ban set-off in other procedural phases as well, albeit only in specific cases and for specified periods of time.

While the restriction after a court-ordered moratorium may be of limited use given that the court may only declare a moratorium with the prior approval of the majority of creditors, the restriction kicking in as of the filing of an application for reorganisation may help protect the cash-flow of those debtors who are eligible for reorganisation under the IA's size test described above.

Guarantees

Guarantees of creditors' claims are not affected by the debtor's insolvency - i.e. the guarantor will pay the creditor (and the creditor can demand and enforce payment) outside the insolvency proceedings – the guarantor will become subrogated into the creditor's procedural position.

The problem with guarantees in Czech law does not come from bankruptcy law but rather from Czech corporate law which contains highly confused rules on intra-group guarantees. In principle, these rules require all intra-group guarantees to be valued by a court-appointed valuer. If the valuation results in a positive number, the beneficiary must pay a fee to the guarantor. Under certain conditions, the guarantee may also need to be approved by the guarantor's general meeting. It is proposed that these rules will be substantially changed in the near future.

Also, another peculiarity with respect to guarantees (and security in general) that one needs to bear in mind is that Czech corporate law traditionally prohibited financial assistance not only to joint-stock companies (akciová spole nost) but also to limited liability companies (spole nost s ruením omezeným). This is has not changed even when when the 2006 amendments to European financial assistance rules in the Second Company Law Directive were implemented in Czech law in 2009, although the prohibition was relaxed, similarly to the relaxation with respect to joint-stock companies as it follows from the amended Second Company Law Directive. However, uncertainties and open issues remain even under the 2009 rules.

New Money Lending

New loans made to the insolvency trustee in liquidation will have priority over general creditors but not secured creditors. In a reorganisation, the situation is somewhat more complicated. As was mentioned in the section on "Priority Ranking of Creditors", secured creditors may, under certain circumstances, have to suffer a dilution by new loans made after the commencement of the reorganisation proceedings which may rank pari passu with pre-commencement secured claims. But this would only be so where

(i) the post-commencement financing was provided following the court's approval of the reorganisation attempt and in furtherance of the goals of the reorganisation, (ii) the relevant financing contract was approved by the creditors committee and (iii) the secured creditor did not use the right of first refusal, granted by the IA, to provide the post-commencement financing himself.

Recognition of Foreign Proceedings

With respect to European Union countries (other than Denmark), the Regulation applies to proceedings opened after 1 May 2004 when the Czech Republic acceded to the EU. Unfortunately, the IA contains no rules on cross-border proceedings outside the EU so there will be significant uncertainty on this point, which is unlikely to be addressed any time soon.

The Slovak Republic

Key Elements:

- Single process for bankruptcy and restructuring
  - Trustee recommendation required for restructuring
  - Automatic stay prevents security enforcement
- Set-off allowed in bankruptcy

Introduction

The current insolvency law of the Slovak Republic is based on the Act on Bankruptcy and Restructuring (Act No. 7/2005 Coll., the "Bankruptcy Act") which came into effect in the Slovak Republic as of 1 January 2006, replacing the Act on Bankruptcy and Compensation (Act No. 411/2004 Coll.)

The Bankruptcy Act also provides for discharge proceedings available to natural persons, but this area of the law is beyond the scope of this publication.

Bankruptcy and Restructuring Processes

Under the Bankruptcy Act, there are two main types of proceedings available to corporate debtors: bankruptcy (in Slovak konkurz), i.e. a sale of the estate (piecemeal or as a going-concern) with satisfaction of creditors through distribution of the proceeds, and restructuring (in Slovak reštrukturalizácia), i.e. reconstruction of the right-hand side of the debtor's balance sheet, based on a restructuring plan approved by creditors and the court.

In bankruptcy, a trustee will displace existing management, gather the assets, list and verify liabilities (both subject to the possible adjustment via adversary proceedings where ownership of assets or amount or rank of claims is disputed), convert the assets in cash through a sale (piecemeal or going concern) and distribute the cash to creditors in an order of priorities that follows, subject to certain exemptions, the ranking of claims under non-insolvency law.

In restructuring, the debtor's management will remain in control, being monitored by a trustee and the court. Upon the court allowing a restructuring attempt through an initial ruling based on the restructuring report prepared by the trustee (see below), the debtor or the trustee attempt to propose and negotiate a restructuring plan, while the company's business is being carried on.

If a debtor is threatened by insolvency or is insolvent, the debtor or the creditor/creditors (subject to the debtor's consent) may authorize a trustee to prepare a restructuring report on whether the debtor fulfills conditions for its restructuring. Authorizing the preparation of a restructuring report, however, does not obviate a debtor's duty to file for bankruptcy in a timely manner.

Provided that the trustee in its restructuring report recommended the restructuring attempt, the court will allow it. The management (or in the event the restructuring is initiated by the creditor, the trustee) will then have 90 days (which the creditor's meeting may extend up to another 60 days) to submit a proposal of a plan to the creditor's meeting.

The creditors' meeting will vote on the plan within 15 days from the plan being submitted to it. The plan may propose any lawful measure of resolution of the company's insolvency as the Bankruptcy Act allows flexibility in this respect.

Creditors will be placed in classes, according to criteria proposed in the plan. The plan will usually provide for a class of secured and unsecured claims, as well as a class of shareholders' claims. These classes can be also divided into separate classes, in order to group together the claims which are substantially the same as regards their legal rights and their commercial nature.

Creditors will vote on the plan by classes; a majority by number of creditors and by amount of claims in each class combined with the approval of the simple majority of votes (based on the amount of their claims) of the present creditors is needed for the plan to be approved. Creditors whose claims are not impaired by the plan will be deemed to have approved the plan.

If the creditor's meeting approved the plan, the plan is submitted for final confirmation to the court. A plan approved by the creditor's meeting will be confirmed by the court subject to several tests, most importantly, from the point of view of legality, the best interest (being the likely pay out in bankruptcy). The court may also substitute the approval of the plan by a particular class of claims if (i) the relevant plan will not be noticeably worse in the position of such class, (ii) a majority of the classes voted in favour of the plan by the required majority, and (iii) the present creditors with a simple majority of votes (counted based on the amount of their claims) voted in favour of plan too.

If the court rejects the plan, it will discontinue the restructuring proceeding and declare bankruptcy over debtor' assets. If the court confirms the plan, it will simultaneously rule on termination of the restructuring. The plan becomes effective upon publication of the court resolution on confirmation of the plan in the Commercial Gazette.

Unless otherwise provided for in the plan, the plan will not affect the rights of creditors to recover their original claims against co-debtors and guarantors of the debtor, nor will it affect the rights of creditors to satisfy their original secured claims from the assets of third parties.

Impact on Third Party Rights

Bankruptcy

Upon publication of the court resolution on declaration of bankruptcy in the Commercial Gazette, the enforcement and/or execution proceedings of the creditors' claims already existing are stayed. Moreover, no enforcement of the security interest over the assets of the debtor securing the debtor's obligations can be commenced.

Unlike in some other jurisdictions, the automatic stay does not extend to the termination of executory contracts. These are subject to (rather unclear) explicit rules in liquidation -essentially, the trustee will be able to assume or reject an executory contract provided that the relevant contract is entered into for indefinite period, the trustee has to do so within 2 months from the court's decision or such shorter period as prescribed by such contract. The main difficulty with this rule is the fact that the Bankruptcy Act effects rejection through the institution of rescission which, under Slovak law, results in the obligation to return performance previously rendered under the contract. Although the counterparty's return claim will rank as an administrative priority claim, this solution is still very disruptive (not least to general pre-commencement creditors who will be subordinated to this claim) and seems out of line with rules dealing with executory contracts in other jurisdictions. Whereas in restructuring, executory contracts are arguably not regulated at all.

In bankruptcy, the stay of the proceedings, as described above, is de facto limited through a rule that allows the secured creditor to issue binding instructions to the bankruptcy trustee as regards the realisation of the collateral. The court may reverse such binding instructions only where they would prejudice the justified claims of the other relevant creditors on or the rules of realisation of the estate prescribed by the Bankruptcy Act.

Upon commencement of the restructuring proceedings, withdrawal of a contractual party from a contract entered into with the debtor for reasons of debtor's delay with fulfilling its obligation under such contract which became due prior to commencement of the restructuring proceeding would be considered invalid. In addition, the contractual arrangements allowing a party to withdraw from a contract for reasons of commencement of restructuring proceeding or bankruptcy are also considered invalid.

Priority Ranking of Creditors

With certain exceptions, the Bankruptcy Act respects the ranking of claims as it follows from non-insolvency law, i.e. it respects both the priority of secured claims and the juniority of subordinated claims.

With respect to secured claims, the priority is absolute in bankruptcy, save for the costs of maintenance and sale of the collateral.

In bankruptcy, unsecured claims will be subject to secured pre-commencement claims, administrative (i.e. post-commencement) claims as well as certain preferred post-commencement claims, most notably unpaid wages and other employee claims, taxes, and customs. In restructuring, the post-commencement claims, trustee's wages and non-monetary claims are considered "preferential claims". Preferential claims are not applied in the restructuring proceeding and remain unaffected by commencement of the restructuring proceedings. Should bankruptcy be declared during the restructuring proceedings, the preferential claims which arose in connection with the running of a debtor's business during the restructuring will be satisfied in their unsecured part from the general bankruptcy estate prior to other unsecured claims.

Subordinated claims will be paid subject to the terms of their contractual subordination. The Bankruptcy Act does not provide for equitable subordination of shareholder or other insider debt claims.

In addition, should bankruptcy be declared as a legal consequence of imposing a protective measure of confiscation of property of an entity within the criminal proceedings, claims of the state arising out of the final court decision on confiscation of property of an entity will be satisfied only after satisfaction of all the preferential claims and claims applied in the bankruptcy proceedings.

Directors' Duties

These can be grouped into general duties of directors to avoid insolvency of the debtor, duties relating to the opening of the proceedings and duties that directors have in the restructuring proceedings where they remain in control.

The former duties include the directors' duty to file for the commencement of bankruptcy proceedings within 30 days after the directors have determined, or should have determined, that the company is insolvent. Insolvency is tested both on the cash-flow basis (i.e. the company's ability to meet current payables) and the balance sheet (i.e. the market value of the company's assets against the total amount of its due liabilities). This duty is subject to very stringent liability for damages -directors who are in default of the duty will be liable to creditors for damages whose amount will be presumed to represent the amount of the claim that remained unsatisfied after the bankruptcy proceedings were terminated or cancelled on the grounds of insufficient assets of the debtor.

The directors who remain in control during the restructuring proceeding, are obliged to act so that they do not diminish the value of the assets of the debtor and do not circumvent the success of the restructuring process.

Challenging Antecedent Transactions

The Bankruptcy Act allows the insolvency trustee or the creditors to sue to avoid antecedent transactions that can be shown to constitute a preference, an undervalue or a transfer with actual fraudulent intent. Trustee and the creditors may bring the action within 6 months from the declaration of bankruptcy by the court. The standard claw-back period is one year for preferences and undervalues and five years for transactions with actual fraudulent intent. For preferences and undervalues, the trustee and/or the creditor must show that the debtor was either insolvent or became insolvent as the result of the transaction. For transactions with connected parties, the claw-back period for preferences and undervalues is extended to three years and the debtor's insolvency will be presumed.

Set-off

Under the Bankruptcy Act, it is not possible to set off a claim against an entity that arose prior to declaration of bankruptcy of such entity against a claim of such an entity that arose following such a declaration. In addition, a claim not applied for in the bankruptcy as prescribed by law, a duly applied claim acquired by transfer after declaration of bankruptcy, and a claim acquired by an antecedent legal act cannot be set off against the debtor's claims. Set-off of any other claims is allowed in bankruptcy. Moreover, claims that have to be applied in the restructuring (e.g. monetary claims arising prior to the commencement of restructuring proceedings) cannot be set off against the debtor after the commencement of the restructuring proceedings.

Guarantees

Guarantees of creditor's claims are not affected by the debtor's insolvency, i.e. the guarantor will pay the creditor outside the insolvency proceeding and will subrogate into the creditor's procedural position, unless, in case of restructuring, the restructuring plan states otherwise.

New Money Lending

The Bankruptcy Act does not specifically deal with new money lending in case of bankruptcy proceedings. The new loans made to the debtor during restructuring proceedings, will, in case of declaring bankruptcy, have priority over general creditors but not the secured creditors.

Recognition of Foreign Proceedings

With respect to European Union countries and the signatories of the EEA Agreement, the EIR applies to proceedings opened after 1 May 2004 when the Slovak Republic acceded to the EU.

Cross-border proceedings outside the EU are subject to the rules in the relevant bilateral agreement if in place, or if not in place, the principle of reciprocity with respect to acknowledgement of foreign judgements on bankruptcy and/or restructuring.

The Agreement on the European Economic Area dated 2 May 1992.

The Council Regulation No. 1346/2000 on insolvency proceedings dated 29 May 2000.

Romania

Key Elements:

- The effects of insolvency proceeding on the rights of secured creditors
- Guarantees
- Ranking of creditors' claims
- Lender liability issues
- Directors' duties
- Recognition of foreign proceedings

Concept of Insolvency under the Insolvency Law

Pursuant to the provisions of the Romanian law on the insolvency proceeding No. 85/2006 as amended and effective (the "Insolvency Law"), a debtor is "insolvent" if it does not have sufficient available monetary funds for the payment of its uncontested, quantifiable and outstanding debts. Actual insolvency is presumed where the debtor has not paid a debt within 90 days of its due date. A debtor will also be held to be insolvent if it can be proved that the debtor is unable to pay its debts in the near future from available monetary funds (imminent insolvency).

The Insolvency Law provides for two types of insolvency proceeding:

(i) a general insolvency proceeding applicable to certain categories of debtors which are (or will imminently be) insolvent (e.g. companies, Economic Interest Groups or any other private law entities performing economic activities); and

(ii) a simplified insolvency proceeding applicable to other categories of debtors (e.g. individuals, traders, family associations or certain categories of companies such as companies which do not have any assets or are not able to produce accounting documents).

Commencement of the Proceeding

The insolvency proceeding is started by filing a petition with the competent court. The petition can be filed by the debtor, by the creditors, or by certain persons or institutions expressly provided by law (e.g. the National Securities Commission, the National Bank of Romania, the Commission for the Supervision of Insurance).

(i) The debtor

Mandatory filing
The insolvent debtor is compelled by law to file a petition of insolvency in case of actual insolvency, within 30 days from the moment it becomes insolvent.

The debtor may disregard this rule if:

a) he is engaged in out-of-court negotiations to restructure its debts; or

b) insolvency occurs during the course of negotiations conducted in the context of an ad-hoc mandate or judicial moratorium (concordat preventiv) procedure, provided that there are strong indications that the results of the negotiations are likely to result in an out of court agreement being reached within a short period of time.

Under these two circumstances the debtor acting in good faith should file for insolvency within 5 days of the negotiations' failure.

Optional filing
The insolvent debtor may also file a petition for opening the insolvency proceeding in case of imminent insolvency.

(ii) The creditors

The petition for opening insolvency proceeding may also be filed by any creditor who has an uncontested claim against the debtor which is quantifiable and has become due, but which has not been paid for more than 90 days. The value of the claim must be minimum RON 45,000. This RON 45,000 minimum claim should be the net value resulting from offsetting the creditor's and the debtor's claims against each other.

(iii) Other persons or institutions

Other persons or institutions, such as the National Bank of Romania and the Commission for the Supervision of Insurances, may begin the insolvency proceeding in respect of entities under their supervision and control.

Simplified Procedure

Under the simplified insolvency proceeding, the debtor falling under the categories provided by the Insolvency Law will directly enter into liquidation proceedings, either upon the opening of the insolvency proceeding, or after an observation period of a maximum 50 days.

Consequences of Commencing Insolvency Proceeding

After considering the insolvency petition, the syndic judge may decide to open either (i) general insolvency proceeding (and appoint a judicial administrator) or (ii) simplified insolvency proceeding (and appoint a temporary liquidator).

Any acts, operations and payments performed by the debtor after the proceeding is commenced are null and void, unless authorised by the syndic judge or expressly provided by the law. Thus, the law provides that during the observation period (i.e. the period between the opening of the insolvency proceeding and the date of the confirmation of the reorganization plan or of the entering into bankruptcy, as the case may be), the debtor may continue its current activities and make payments to the known creditors within the common terms of exercising the current activity, either under the supervision of the judicial administrator (if the debtor maintains the right of administration of its business) or under the management of the judicial administrator (if the debtor loses the right of administration of its business). The right of administration of the business consists of the right to manage the activity, the assets and to dispose of such assets -including those assets acquired subsequent to the opening of the proceeding.

On the commencement of insolvency proceeding, the debtor loses the right of administration of its business, unless the debtor has declared, in certain cases, the intention to reorganise.

The right of administration terminates de jure on the date the bankruptcy proceeding is commenced.

Commencement of insolvency proceeding is notified to all creditors, as well as to the debtor and to the Trade Registry. The notification will state a term of maximum 45 days within which creditors should submit claims in the insolvency proceeding. The judicial administrator examines these claims to determine their legitimacy, exact value and priority. The outcome of such examination is recorded in a preliminary table of claims registered with the competent court. The debtor, the creditors and any other interested person may challenge such preliminary table in court. The preliminary table of claims is finalised and registered with the competent court after all such challenges are settled.

The syndic judge may designate a committee of 3-5 creditors from among the largest of the secured claims, the state/public authority creditors who are owed duties, taxes, contributions, fines and other sums (budgetary claims), and unsecured claims. If, due to the small number of creditors, the syndic judge does not consider the designation of a creditors' committee to be necessary, certain attributions of such committee may be exercised by the creditors' meeting.

This committee can be replaced by a committee of 3 or 5 creditors designated by the creditors' meeting from those with the largest secured, budgetary and unsecured claims out of the first 20 creditors willing to participate in the committee. The creditors' committee will, amongst other matters, analyse the debtor's situation and make recommendations to the creditors' meeting regarding the continuation of the debtor's activity and the proposed plans of reorganisation, report to the creditors' meeting on the judicial administrator's or the liquidator's activity, request the annulment of any detrimental transactions made by the debtor.

Judicial reorganisation

Following the commencement of insolvency proceeding, any creditor, the debtor or the judicial administrator has the option (upon meeting certain terms and conditions) to request a judicial reorganisation of the insolvent debtor. Judicial reorganisation is a procedure that facilitates the reorganisation of the debtor's business in order to allow payment of its debts according to a plan of reorganisation, which may provide the following options: (i) the operational and/or financial restructuring of the debtor; and/or (ii) the corporate restructuring by amending the share capital structure; and/or (iii) the reduction of the business by liquidation of certain assets. The plan is submitted for approval to the creditors and confirmed by the court. Should the syndic judge approve the plan, the reorganisation procedure may not last more than three years starting with the date of the confirmation. This period may be extended with a period of maximum one year upon the recommendation of the judicial administrator, after the expiry of a term of at least 18 months from the confirmation of the plan, if the proposal is approved by at least two thirds of the creditors with outstanding debts as at that date.

During the reorganisation, the debtor shall manage its activity under the supervision of the judicial administrator and in accordance with the plan of reorganisation, until the syndic judge decides that either (i) the insolvency proceeding is terminated and the debtor resumes its normal commercial activity, or (ii) the reorganisation is terminated and the debtor enters into liquidation (I.e. where the reorganisation plan was unsuccessful).

Liquidation

If no plan of reorganisation was proposed or approved or if the plan was unsuccessful, or if the judicial administrator recommends liquidation and the creditors approve it, the syndic judge may order the winding-up of the debtor, the liquidation of its assets and the distribution of the proceeds thereof.

Challenges

Fraudulent transactions

An insolvency official (i.e. the judicial administrator or liquidator) may challenge the following types of acts performed prior to the opening of the insolvency proceeding:

(i) donations provided during the 3 years preceding the commencement of the insolvency proceeding, (except for humanitarian donations);

(ii) transactions at an undervalue, entered into during the 3 years preceding the commencement of insolvency proceeding;

(iii) transactions intended to evade specific assets of the debtor from other creditors or to harm the rights of such creditors, executed during the 3 years preceding the commencement of insolvency proceeding;

(iv) the transfer of ownership rights to a specific creditor made in order to discharge a previous debt due to such creditor, if executed during the 120 days period preceding the commencement of the proceeding if the amount that such creditor would have obtained in a liquidation of the debtor would have been lower than the value of such transfer;

(v) the creation or perfection of security in favour of an unsecured claim, during the 120 days period preceding the commencement of the proceedings;

(vi) prepayments of debt made within 120 days preceding the commencement of proceeding, if the due date of such debts would have occurred at a date after the commencement of the proceeding;

The latter three transactions cannot be annulled provided that:

(a) they are entered into in good faith following an agreement with the creditors;

(b) the agreement with the creditors is concluded as a result of out of court negotiations for the restructuring of the debtor's debts; and

(c) the agreement should be of nature to lead, in a reasonable manner, to the financial redress of the debtor and should not have as purpose the prejudice and/or discrimination of other creditors.

These exceptions apply also in case of acts concluded within the judicial moratorium and ad-hoc mandate legal procedure; and

(vii) transfer or undertaking of obligations made by the debtor during the 2 years preceding the opening of the insolvency proceeding with the intention to conceal or delay the insolvency or to defraud natural or fictitious persons who were creditors on the date of transfer of operations with derivative financial instruments, including the close out of a netting contract concluded on the basis of a qualified financial contract, or who became creditors at a subsequent date.

Disadvantageous transactions

The following transactions, concluded within the 3 years period preceding the opening of the insolvency proceeding may also be cancelled if these are detrimental to creditors:

(i) in relation to company's transactions between the debtor and a shareholder holding at least 20% of the capital or 20% of the voting rights, where the debtor is a limited liability company;

(ii) in relation to an Economic Interest Group, transactions with a member or director;

(iii) in relation to the company's transactions between the debtor and a shareholder holding at least 20% of the debtor's shares or 20% of the voting rights, where the debtor is a joint stock company;

(iv) transactions with a director, manager or member of the supervisory bodies of the debtor, where the debtor is a joint stock company or a limited liability company;

(v) transactions with any person, holding a dominant position over the debtor or its business;

(vi) transactions with a co-owner over a common asset.

The insolvency official may challenge the above transactions within one year from the expiry date of the term during which the report on the debtor's insolvency status has to be drafted by the insolvency official, but not later than 16 months from the commencement of the insolvency proceeding. If the insolvency official fails to take action to challenge any of the above-mentioned transactions, the creditors' committee may also challenge these transactions before the court. However, no such claim may be brought against these transactions if performed by the debtor in the ordinary course of its business.

Pending Contracts

The Insolvency Law provides for the general rule that ongoing contracts entered into by the insolvent debtors are deemed to be maintained when the insolvency proceeding is opened.

Also, any contractual provisions which provide for termination of such ongoing contracts for the reason of insolvency proceeding being opened against a party are null.

In order to maximise the value of the debtor's assets, the insolvency official may unilaterally terminate any contract, any unexpired lease or other long term contracts, to the extent that such contract has not been performed entirely, or substantially by all the parties involved. The insolvency official must reply within 30 days to a notice from a counterparty requesting the insolvency official to terminate the contract; if the insolvency official fails to reply to such request, he shall not be able to require performance under the respective contract, which will be deemed unilaterally terminated.

If a contract is terminated unilaterally by the insolvency official either expressly or due to failure to reply to the counterparty's notice, the contractor may file a claim for damages against the debtor.

During the observation period the judicial administrator can amend the credit contracts so as to ensure equivalence of future performance.

Where a contract provides for periodic payments from the debtor, the maintenance of the contract does not make the insolvency officer liable to pay sums due under the contract which relate to periods prior to the opening of the proceeding.

Security Enforcement

As a rule, starting with the opening of the proceeding, all judicial and extrajudicial actions and the enforcement actions for the recovery of debts from the insolvent debtor are suspended.

In some cases (e.g. when the asset is not material for the success of the proposed reorganisation plan, or the asset belongs to a larger operational system and its independent sale would not affect the value of the system), a secured creditor can make a request that the court cancels such suspension with respect to that asset, provided that (i) the taxes, stamp duties and other expenses determined by the sale of the assets are paid and (ii) the provisions applicable to the realisation of assets are observed.

In liquidation proceedings, the proceeds of a charged asset will be applied directly to reduce the secured debt.

Guarantees

Romanian law allows downstream and upstream guarantees in most circumstances, provided that the corporate benefit of the transaction to the guarantor can be established. Due to the fact that companies are established for the purpose of obtaining profit, corporate benefit has to be established in all situations. Although downstream guarantees are generally valid, in certain situations upstream guarantees could be considered null and void if corporate benefit cannot be established.

According to Romanian Companies' Law No. 31/1990, certain restrictions apply to guarantees provided to directors of companies. For example, a company is prohibited from granting a guarantee in respect of obligations of its directors or his relatives. Also, the prohibitions apply where the beneficiary of the guarantee is a company where the spouse or the relatives of the director of the guarantor is a director or owns more than 20% of the share capital.

Under Romanian Companies' Law No. 31/1990, a company cannot grant any advance of money, lend its own money or charge its own property for the purpose of a third party subscribing or purchasing its shares. A guarantee provided by a company to a third party which uses the guarantee in connection with the subscription or purchase of shares of such company is considered to be null and void. It is generally thought that this restriction applies only to joint stock companies (S.A.), but there is a view that such restrictions could be held also to apply to private limited liability companies (S.R.L.).

The Insolvency Law provides for the nullity of any transaction which is prejudicial to other creditors, entered into during the 3 years preceding the commencement of insolvency proceeding with, amongst others, the following persons:

a) a shareholder holding at least 20% of the share capital or 20% of the voting rights in the general meeting of the shareholders of a limited liability company;

b) a member or a director, when the debtor is part of a Economic Interest Group;

c) a shareholder holding at least 20% of the debtor's shares or 20% of the voting rights in the general meeting of the shareholders of a joint stock company;

d) a director, a manager or a member of the supervisory bodies of the debtor, where the debtor is a joint stock company of a limited liability company; and

e) any other person holding a dominant position in respect of the debtor or its business.

Payment Priorities

According to the Insolvency Law, the proceeds of realisation of the secured assets are to be distributed to the secured creditors (for the satisfaction of the principal amount, the interest, penalties and any other costs), after payment of the taxes, stamp duties and any other expenses determined among others by the sale of such assets. Out of the secured claims, the claims incurred during the insolvency procedure, as part of the implementation of a reorganisation plan shall be paid in priority to the secured claims incurred before the proceedings have been opened.

If the proceeds of enforcement are insufficient for the full repayment of the secured debt, such creditors will be treated as unsecured for the remaining part of the debt and will be satisfied according to the general order applicable for the other types of claim.

A secured creditor is entitled to take part in the distribution of any proceeds made prior to the realisation of the asset securing its claim, provided that any amounts received will be subsequently subtracted from the proceeds of realisation of the secured asset.

In liquidation, the general order of payment of unsecured debts is as follows:

a) taxes, stamp duties and other expenses incurred in connection with the insolvency proceeding;

b) employment claims;

c) loans granted after the opening of the insolvency proceeding, together with interest and expenses, and other receivables resulted from the continuation of the debtor's activity, after the opening of the insolvency proceeding;

d) budgetary claims;

e) (where applicable) amounts due pursuant to alimony obligations, child support or subsistence receivables;

f) (where applicable) certain amounts for the subsistence of the debtor and his family, when the debtor is natural person;

g) claims by certain types of creditors such as banks, landlords, suppliers of goods and services;

h) other unsecured debts; and

i) subordinated debts, in the following order:
   (i) loans granted by an associate or a shareholder holding at least 10% of the share capital or of the voting rights, or by a member of the Economic Interest Group; and
   (ii) gratuitous acts.

Payments towards creditors having the same rank will be made proportionally. A debt from a certain class, as listed above, will be paid only after complete payment of the debts in the superior class.

The following amounts will be set aside in case of partial payments:

a) proportional amounts owed to creditors with contingent claims;

b) proportional amounts owed to bond holders who have not presented the originals for payment;

c) proportional amounts for claims admitted provisionally; and

d) amounts to cover future expenses in respect of debtor's assets.

Directors' Duties

The insolvent debtor is compelled by law to file a petition of insolvency in case of actual insolvency, within 30 days from the occurrence of the insolvency. Please refer to section "Commencement of the Proceeding" for relevant exceptions.

At the judicial administrator or liquidator's request, the court may decide that some of the debts should be paid by the members of the management / and / or supervisory bodies of the debtor personally or by any other party who has contributed to the debtor's insolvency and has been involved in the following activities:

a) using the assets or loans granted to the debtor for their personal use or for that of a third party;

b) performing commercial activities in their personal interest, in the name of the debtor;

c) continuing, in their personal interest, an activity which was clearly leading the debtor to cessation of payments;

d) false accounting, concealment of accounting records or failing to observe the legal requirements in respect of accounting;

e) embezzling or hiding debtor's assets, or falsely increasing the debtor's debt;

f) using ruinous methods to procure funds in order to postpone the cessation of payments; or

g) paying or deciding to pay with priority a creditor and to the detriment of the other creditors in the month prior to cessation of payments.

In the latter case, the legal representative of the debtor shall not be held liable provided that:

(a) payments are in good faith following an agreement with the creditors;

(b) the agreement with the creditors is concluded as a result of out of court negotiations for the restructuring of the debtor's debts; and

(c) the agreement should be of nature to lead, in a reasonable manner, to the financial redress of the debtor and should not have as purpose the prejudice and/or discrimination of other creditors.

These exceptions apply also in case of acts concluded within the judicial moratorium and ad-hoc mandate.

Also the law establishes that certain criminal acts of the directors are punishable with imprisonment.

Lender Liability

Although Romanian law does not use the concept of "shadow director" or "de facto director", the Insolvency Law provides that the court may decide that part of the debt be paid by any person who caused the debtor's insolvency through certain actions, as listed above. It could be considered that this provision would include a person exerting powers as a de facto director. The Romanian law does not regulate the situation when the lender is in the position of being able to influence the management of the company.

Pursuant to the Insolvency Law, certain types of transaction may be challenged when falling under the definition of fraudulent or disadvantageous transactions, including transactions with any party, holding a dominant position in respect of the debtor or its business, or transactions entered into by the debtor during the 2 years preceding the opening of the insolvency proceeding with the intention to conceal the insolvency or delay the onset of insolvency proceeding.

The Romanian Civil Code provides for a certain type of judicial action to be used by a general creditor in order to challenge a transaction entered into by the debtor which has the effect of prejudicing other creditors (actiune revocatorie).

New Money Lending

Loans granted after the commencement of the insolvency procedure, and other debts incurred due to the continuation of the debtor's activity after the commencement of the insolvency procedure have priority over certain pre-insolvency debts.

Recognition of Foreign Insolvency Proceeding

Law No. 637/2002 on Private International Law Relations in the Context of Insolvency Proceeding as amended (the "Cross Border Insolvency Law") implements in Romania the UNCITRAL Model Law on Cross-Border Insolvency made in 1997 and has been in force since 1 July 2003. Additionally, the European Council Regulation No. 1346/2000 on insolvency proceedings is directly applicable in Romania since Romania's accession to the European Union on 1 January 2007.

Other relevant EU directives have also been implemented through separate legislation, in particular:

a) Law No. 503/ 2004 on financial recovery and bankruptcy of insurance undertakings implements in Romania the provisions of Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding-up of insurance undertakings, and

b) Government Ordinance No.10/2004 on judicial reorganisation procedure and bankruptcy of credit institutions, as amended, implements the Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions.

The judicial moratorium ("concordat preventiv") and the ad-hoc mandate

Law No. 381/2009 introduced the judicial moratorium ("*concordat preventiv*") and the ad-hoc mandate ("Law No. 381/2009") procedures on 13 January 2010 and implements, as an alternative to the burdensome and time consuming insolvency proceedings, a contractual mechanism for a company in distress to reorganise its activity outside the insolvency proceedings, with limited involvement from the court.

Law No. 381/2009 applies to any legal entity which is in financial distress and is not in insolvency. The Law also applies to regulated entities, such as banks and investment firms.

The purpose of the law is to safeguard a business in distress through one of the following procedures: (i) ad-hoc mandate or (ii) judicial moratorium.

The ad-hoc mandate represents a confidential procedure opened upon the debtor's request whereby an ad-hoc proxy, appointed by the court, negotiates with the creditors with a view to reaching an agreement between one or more creditors and the debtor for overcoming the financial distress of the undertaking.

The judicial moratorium represents an agreement between the debtor and the creditors holding at least 2/3 of the receivables that are accepted and not challenged, whereby the debtor proposes a plan for the revival of its business and for covering its debt and the creditors accept to support the debtors' efforts to this end.

Law No. 381/2009 implements a more flexible mechanism, in comparison with the insolvency proceedings, for a company in distress to reorganise its activity, and is contractually enforceable against all creditors.

Guidelines for Out-of-Court Restructuring

Finally, it is worth mentioning that a group of representatives of the Ministry of Justice, the National Bank of Romania and the Ministry of Public Finance have drafted a set of guidelines for out-of-court restructuring procedures. The guidelines apply to debtors, creditors and the relevant public institutions and deal with concepts such as standstill periods, enforcement moratorium, information flow and transparency, confidentiality, reorganisation plan, new monies, etc.

The guidelines are indicative and not compulsory and they were published on the aforementioned authorities' websites.

Ukraine

Key Elements:

- How to commence insolvency proceedings in Ukraine
- The 3 main stages of insolvency proceedings
- Challenging transactions during insolvency proceedings
- Liability for insolvency and actions during insolvency
- Insolvency implications against banks
- Insolvency implications against state-owned companies
- Insolvency implications against foreign debtors

Introduction

The insolvency legislation in Ukraine may be divided into two types:

- Legislation regulating insolvency proceedings against banks.

  This is based on the Banks And Banking Activity Law dated 7 December 2000 and a number of resolutions passed by the Board of the National Bank of Ukraine.

- Legislation regulating insolvency proceedings against debtors who are not banks.

This is based on two legislative acts:

- **The Insolvency Law** (the Law of Ukraine "On Reinstatement of Solvency of the Debtor or Declaring it Bankrupt") dated 14 May 1992 and significantly amended in 1999, which is the principal law on insolvency proceedings in Ukraine against debtors who are not banks.
- **The Commercial Proceedings Code** dated 6 November 1991 and significantly amended in 2001, which regulates different court procedures within insolvency proceedings and is applicable if the Insolvency Law does not contain specific provisions on a particular issue.

In addition, numerous limitations and restrictions are set out with respect to the commencement and course of insolvency proceedings against certain types of debtors including for example, state-owned companies, significant enterprises employing more than 5,000 employees, certain financial institutions (stockbrokers, insurances companies, fund managers), and energy companies.

The courts (primarily, the Supreme Court of Ukraine and the High Commercial Court of Ukraine) have significant influence on the application of insolvency legislation and how it is interpreted during their consideration of specific insolvency proceedings or by providing general clarifications as a part of summarizing and analyzing the insolvency court practice.

Limitations

This note only discusses insolvency proceedings applicable to debtors registered in Ukraine. It does not discuss insolvency proceedings against banks or the companies listed above in detail. However, the main procedural and other differences applicable to insolvency proceedings against banks and state property companies are briefly outlined at the end of this note.

Commencement of Insolvency Proceedings

Insolvency petition by the debtor

Voluntary petition

Insolvency legislation in Ukraine provides the debtor with a right to file an insolvency petition with the court upon certain grounds. It also sets out a number of circumstances where the debtor is obliged to apply to the court for commencement of insolvency proceedings against itself.

Compulsory petition

The debtor must initiate insolvency proceedings within one month of any of the following circumstances occurring:

- If fulfilment by the debtor of its obligations to one or more creditors would result in the debtor being unable to satisfy the claims of its other creditors;
- if an authorised governing body (in most cases -the shareholders' meeting) of the debtor decides to file for an insolvency proceeding; or
- if during a liquidation procedure, which has been initiated outside insolvency proceedings (i.e. voluntary liquidation), the debtor is unable to satisfy the claims of all of its creditors.

Insolvency petition by a creditor

Any creditor, including authorized governmental agencies (e.g. state tax authorities and state customs authorities) is entitled to initiate insolvency proceedings.

Unless otherwise specified by law, a creditor who intends to initiate insolvency proceedings must have an unpaid monetary claim, which is:

- Equal to or exceeds the equivalent of approximately USD 36,200;
- Indisputable (a claim will be deemed to be indisputable if it is supported by official enforcement documentation (e.g. a court decision) or settlement documents pursuant to which the debtor's money must be debited by law); and
- Not satisfied within 3 months from the date when a claim became due and payable.

The Stages of Insolvency Proceedings

Property administration

This first stage of insolvency proceedings serves to prevent the debtor's assets from unreasonable disposal and establishes control over them before the creditors' committee decides (with the court's subsequent approval) the debtor's fate (e.g., whether to rehabilitate or liquidate the debtor).

The above involves the following steps:

Appointment of property administrator

In most cases the property administrator is a licensed independent entrepreneur who administers the property on the basis of a court ruling. Usually, the court approves the petitioning creditor's (i.e., the one that files an insolvency petition) nomination for property administrator.

Role of the property administrator

The role of the property administrator is to preserve the debtor's assets from unreasonable use and disposal, to identify the debtor's creditors and to convene the first creditors' meeting.

Moratorium and restrictions on payments

The initiation of insolvency proceedings by a Ukrainian court normally triggers a moratorium on the satisfaction of certain creditors' claims.

During the moratorium period:

- the debtor will be prevented from satisfying claims and from entering into arrangements aimed at securing the claims which have become due before the date of the initiation of insolvency proceedings;
- enforcement against the debtor's assets shall be suspended irrespective of whether or not the obligation has matured[3]; and
- no default interest or any other penalties or sanctions for breaching the monetary obligations may be applied.

The moratorium will continue until the end of the insolvency proceedings. Technically, the moratorium does not apply to payments which become due after the initiation of insolvency proceedings. After the initiation of insolvency proceedings, the debtor may, subject to various approval processes, be allowed to make contractual payments if the contract is not accelerated before the initiation of insolvency proceedings. However, in practical terms, if the debtor refuses to make contractual payments after the insolvency proceedings have been initiated, no enforcement (except for potentially the enforcement of the security) against the debtor is possible because, as mentioned above, the enforcement will be suspended during the moratorium.

The moratorium does not apply to:

(i) payments which become due upon or after the initiation of bankruptcy proceedings;

(ii) payments to creditors approved under the rehabilitation plan;

(iii) payments made as a part of any liquidation proceedings in relation to the debtor;

(iv) payments of salary, alimony, authorial remuneration and damages awarded for death or personal injury claims; and

(v) set-off by creditors.

Restrictions on transactions

The property administration manager The property administration manager does not normally replace the CEO or other management of the debtor. However, if the CEO breaches the law, the court may, upon the application of the creditors' committee, remove the CEO from office and temporarily appoint a property administration manager as the CEO. During the property administration phase, the debtor's CEO requires the property administrator's prior consent to enter into the following contracts:

(i) any disposal of real estate;

(ii) granting or taking loans (credits), issuing sureties, guarantees, executing assignment agreements, entering into trust arrangements; and

(iii) significant contracts (i.e., whereby the contractual amounts exceed one percent of pool value of the debtor's assets).

Termination of property administration

The property administration stage terminates with a court ruling made in a substantive court hearing. According to the time frame set out in the law, this hearing should be held not later than 7 months of the filing of the insolvency petition with the court. However, in practice such period is quite often not followed. The court ruling should be based on the decision of the creditors' committee and include one of the following conclusions:

- Initiation of rehabilitation proceedings against the debtor;
- Initiation of liquidation proceedings against the debtor; or
- Termination of insolvency proceedings against the debtor.

Rehabilitation proceedings

Once the property administration proceedings end, the creditors' committee is authorized to apply to the court for initiation of rehabilitation proceedings. The latter is a system of measures aiming to reinstate the debtor's solvency.

[3] Based on the clarifications of the Supreme Court of Ukraine (December 2009) and recent amendments to the enforcement regulations (March 2011) it has become permissible to enforce a security despite the commencement of the insolvency against a debtor. However, the relevant amendments have not been introduced to the Insolvency Law which still prohibits any kind of enforcement (including enforcement of a security) during insolvency. Therefore, enforcement of a security during enforcement may still be difficult in practice.

This stage involves the following steps:

Proposal for rehabilitation

The law does not set out any requirements regarding the content of the application to initiate rehabilitation proceedings.

Appointment of the rehabilitation manager

The creditors' committee approves the candidate for the rehabilitation manager and files the relevant application with the court. Once the court has given it's ruling, the rehabilitation manager begins the debtor's rehabilitation. The creditors (including lenders) may not be directly involved in the management of the debtor because the rehabilitation manager is solely responsible for this. However, the creditor's committee has a right to approve any significant contracts which the rehabilitation manager intends to enter into.

Powers of the rehabilitation manager

The rehabilitation manager should develop the rehabilitation plan, obtain consent for it from the creditors and file it with the court for approval. The rehabilitation manager supersedes the debtor's CEO and is responsible for carrying out the rehabilitation plan. The powers of the rehabilitation manager also include producing an inventory the debtor's assets, collecting the receivables, unilateral termination of agreements and challenging antecedent transactions entered into by the debtor.

Within three months of the commencement of the debtor's rehabilitation, the rehabilitation manager may unilaterally refuse to perform the debtor's contracts which were concluded before the date of commencement of insolvency proceedings provided that:

- The fulfilment of such contract would cause damage to the debtor;
- The contract is a long-term contract (i.e. exceeds one year) or is so structured that the debtor receives benefits from a long-term perspective;
- Fulfilment of the contract would prevent the restoration of the debtor's solvency.

The law is not clear as to whether all of these conditions or any of them must be fulfilled in order for the rehabilitation manager to be able to refuse to perform a contract. In 2009, the Supreme Court of Ukraine clarified that one condition for refusal would be sufficient. However, we are aware of several court cases that are not consistent on this issue and it is generally not clear how these provisions should apply.

Rehabilitation plan

Ukrainian insolvency law encourages the creditors' committee to come up with an action plan to rehabilitate the debtor. The rehabilitation plan must be approved by the court and may last for up to 12 months (although the court may extend it for a further six months).

The main options for a "rehabilitation plan" are as follows:

(i) the restructuring of the debtor; (ii) change of business activities of the debtor; (iii) termination of unprofitable production; (iv) temporary suspension of payments or deferral of payments as well as forgiveness of debt in respect of which an amicable agreement must be concluded; (v) collection of receivables; (vi) restructuring the debtor's assets; (vii) selling the debtor's assets; (viii) assignment of debts to the investors; (ix) discharge of debtor's employees who will not be engaged in the realization of the rehabilitation plan; (x) performance of the debtor's duties by third persons; and (xi) exchange of the creditors' claims for debtor's assets or debtor's equity.

Restrictions on payments

Upon commencement of rehabilitation proceedings the moratorium on satisfaction of creditors' claims remains effective. However, it has no effect upon the recovery of claims under the rehabilitation plan. Only the court that hears the insolvency proceedings may restrict the disposal of the debtor's assets (as well imposing other limitations) provided that such limitations do not obstruct the rehabilitation of the debtor.

Restrictions on transactions

Only the rehabilitation manager is authorized to enter into agreements on behalf of the debtor during the rehabilitation proceedings. However, when it comes to the conclusion of considerable contracts and/or contracts with affiliated persons, the prior approval of the creditors' committee is required.

Termination of rehabilitation proceedings

The rehabilitation proceedings may either be converted into liquidation proceedings or be terminated. In the latter case, the debtor's solvency is deemed reinstated.

Transition to liquidation proceedings

If fulfilment of the rehabilitation plan has not actually reinstated the debtor's solvency, the court, upon the application of the creditors' committee, makes a ruling declaring the debtor bankrupt and initiates the debtor's liquidation.

Liquidation proceedings

Liquidation normally should last for one year, subject to a potential extension of up to six months. It involves the following steps:

Appointment of a liquidation manager

Upon the application of the creditors' committee, the court, while initiating the liquidation proceedings, will also approve the appointment of the liquidation manager.

Powers of the liquidation manager

The main role of the liquidation manager is to collect the debtor's assets and to agree and pay the claims according to the statutory rankings.

The liquidation manager is mainly entitled to:

- Sell the debtor's non-monetary assets;
- Dismiss the debtor's management and employees;
- Enter into an amicable settlement on behalf of the debtor; and
- Request the court to invalidate agreements entered into by the debtor.

Restrictions on payments

Upon commencement of liquidation proceedings:

- The business activity of the debtor will be terminated;
- All monetary obligations owed by the debtor will become due and payable;
- Commercial sanctions in respect of the defaults in obligations may no longer be imposed on the debtor; and
- All seizures of the debtor's assets will be cancelled and no new ones may be imposed.

Liquidation pool

At the liquidation stage, the debtor's entire assets are included in the pool of assets that comprises its bankruptcy estate. Creditors' claims are to be met during insolvency proceedings only in monetary form. If the pool includes non-monetary assets, then a liquidation manager must sell them and use the proceeds for satisfying such claims.

Closing of accounts

At the liquidation stage, all but one of the debtor's bank accounts are closed, and the balances are transferred to that single account.

Rankings

In the event that the court declares the debtor bankrupt, proceeds realized from the sale of its assets in the course of liquidation proceedings will be distributed in the following order of priority:

(i) claims secured by a pledge/mortgage of the relevant assets (but only to the extent of the proceeds realised through the enforcement of such security);

(ii) claims for paying employees' salaries for the three-month period before insolvency proceedings were initiated by the court, other payments due to the employees and expenses incurred in connection with insolvency proceedings;

(iii) claims for taxes;

(iv) unsecured creditors' claims;

(v) claims of the employees to receive their contributions to the share capital of the debtor; and

(vi) any other claims (in particular, penalty sums and other sanction payments).

Lenders providing new monies to the debtor during insolvency proceedings do not have any special priority or special ranking under the Insolvency Law.

Termination of liquidation

Liquidation proceedings normally end with removal of the debtor from the Companies' Register.

Amicable settlement

The creditors may elect to enter into an amicable settlement with the debtor, pursuant to which they agree to defer payments, allow payments by instalments and/or to forgive the debt. In general, this settlement may be reached at any stage of the insolvency proceedings and becomes effective upon its approval by the court (and such approval by the court is a ground to terminate the insolvency proceedings).

Challenging Transactions during Insolvency Proceedings

Under the laws of Ukraine, transactions entered into by a debtor prior to commencement of insolvency proceedings can be challenged (invalidated) on a number of grounds.

Void and voidable transactions

The Civil Code of Ukraine provides that a transaction can be classified as invalid if it is either a "void" or "voidable" transaction. Once a transaction becomes invalid, it may no longer create legal rights and obligations and results in a reciprocal restitution. A void transaction is invalid by operation of law from the outset and does not require any court decision on its invalidation. In contrast, a voidable transaction can be declared invalid only by a court. For example, the latter includes transactions of legal entities made beyond their powers, fraudulent transactions and transactions entered into under duress. The limitation period for implementing the consequences of a void transaction is ten years from the date the void transaction was commenced. For voidable transactions, the limitation period is three years and a claim seeking a declaration of an invalid transaction must be filed within the shorter of: (i) the date the transaction occurred; and (ii) the date on which the claimant knew or should have known of the circumstances serving as grounds for invalidating the transaction.

Voidable transactions under the Insolvency Law

Following commencement of insolvency proceedings, under the Insolvency Law, a court-appointed insolvency manager will be entitled to challenge transactions and decisions of the debtor at any stage of insolvency proceedings on the general grounds for invalidation set out in the civil legislation. However, for rehabilitation and liquidation proceedings, special provisions of the Insolvency Law entitle the rehabilitation manager and the liquidation manager respectively, on the specific grounds described below, to challenge the transactions entered into by the debtor both before and after the commencement of insolvency proceedings. Since no special limitation periods are envisaged with respect to these powers of the court-appointed insolvency manager, the general principles of the Civil Code with respect to limitation periods of voidable transactions will apply.

Invalidation claim by the rehabilitation manager

During the rehabilitation period, the rehabilitation manager may apply to the court to challenge an agreement if:

- The relevant agreement has been executed with an "affiliated person" (the definition of an "affiliated person" includes a legal entity in which the debtor, managers or accountants of the debtor, or relatives thereof, are participants), as a result of which creditors of the debtor have incurred or may incur losses; or
- The relevant agreement is executed with a particular creditor or any other person in the period preceding six months the court decision on initiation of the rehabilitation of the debtor and such agreement either:
- Establishes preferential treatment of one creditor as compared to the other creditors, or
- Contemplates cashing out or distributing assets of the debtor to one of its shareholders, in connection with the shareholder's withdrawal from the debtor.

Invalidation claim by the liquidation manager

- In the course of liquidation, the liquidation manager can apply to the court to challenge an agreement if:
- Fulfilment of the agreement would cause damage to the debtor;
- The agreement is a long-term agreement (i.e. exceeds one year) or is structured in a way that the debtor receives benefits in the long-term perspective; or
- Fulfilment of the agreement would prevent the restoration of the debtor's solvency.

Liability for Bankruptcy and Actions during Bankruptcy

Shareholders' civil liability for insolvency (bankruptcy)

The general principle of Ukrainian law is that shareholders (participants) of a company will not bear liability for the debts of the company unless otherwise stipulated by law and/or the constitutional documents of the company. The same rule applies to insolvency proceedings.

However, under the Ukrainian Commercial Code, if, due to acts or omissions of the holding company (as described below), the debtor is found insolvent and declared bankrupt, the holding company will be secondarily liable for the obligations of the bankrupt company. The law is not clear as to whether this provision of the Commercial Code applies to foreign holding companies. The Commercial Code defines the holding company as an open joint-stock company that owns shares issued by, at least, two or more companies (except for shares of state-owned companies).

The Commercial Code further refers to a separate Ukrainian law on holding companies (the "Holding Company Law") which provides that an open joint stock company may qualify as a holding company provided that: (a) the block of shares controlled by the holding company exceeds 50% of all the issued shares; or (b) the holding company has some other decisive influence over the business activity of the controlled company. The Holding Company Law applies only to Ukrainian companies. It might be argued that the secondary liability for holding companies applies only to Ukrainian holding companies. We believe, however, that there is a risk that a court may apply the secondary liability rule to a foreign company that meets the criteria for a holding company under the Commercial Code. This issue has not yet been tested in court practice.

Criminal liability for insolvency (bankruptcy)

The Criminal Code of Ukraine provides for criminal liability (fine of up to approx. USD 6,400 or custodial restraint of up to 3 years) of individuals (including the management and directors of the company) for the following offences:

- **Fraudulent bankruptcy**, i.e. when the founder (participant, shareholder) or the official of the company as well as the individual entrepreneur knowingly makes an official statement about the financial insolvency and such statement causes gross material damages to the creditors or the State.
- **Deliberate bankruptcy**, i.e. when the founder (participant, shareholder) or the official of the company knowingly performs actions that have resulted in the financial insolvency of the company and caused gross material damage to the creditors or the State.
- **Concealing permanent insolvency**, i.e. when the founder (participant, shareholder) or the official of the company knowingly conceals, by means of applying false information, the company's financial insolvency and this causes gross material damages to the creditor.
- **Illegal actions during bankruptcy**, i.e. when the founder (participant, shareholder) or the official of the company against which the insolvency proceedings are commenced by the court, knowingly conceals the property, information on property, illegally transfers the property or disposes of it as well as forges, conceals or destructs the documents of company's business activity and such illegal actions causes gross material damage.

Insolvency Implications against the State and Municipal Property Companies

The Ukrainian insolvency law applies to all the legal entities and individuals, with the exception of treasury enterprises. It also provides for several restrictions in relation to the insolvency proceedings against the State companies or companies where the State has a significant participatory interest.

A municipal enterprise may be immune from the insolvency proceedings, provided that the municipal council adopts (at a plenary meeting) an individual decision that provisions of the Insolvency Law will not be applicable to such municipal enterprise.

Furthermore, until 1 January 2013 the Insolvency Law is not applicable to mining enterprises in which the State holds at least 25% of the authorised share capital. The law prohibits initiating liquidation proceedings against such companies because sale of the debtor's assets would be the only way to satisfy creditor claims.

Please also note that pursuant to the Law on Moratorium over Enforced Sale of Property dated 29 November 2001, it is not permitted to enforce against certain assets owned by companies in which the State holds at least 25% of share capital. Such assets include real estate and other fixed assets involved in the production activities of the debtor.

Insolvency Implications against Foreign Debtors

The Insolvency Law applies only to Ukrainian legal entities, i.e. the ones having its registered address within the territory of Ukraine. Ukrainian bankruptcy courts will decline to assert their jurisdiction over foreign debtors in insolvency matters. In relation to potential secondary liability of a foreign holding company, please refer to section "Shareholders' civil liability for insolvency (bankruptcy)"above.

Ukraine has neither incorporated UNCITRAL Model Law on Cross-Border Insolvency nor enacted any other similar regulations which would effectively provide for a possibility of commencement of ancillary insolvency proceedings against foreign debtor in Ukraine.

However, foreign court judgments (including judgments of foreign insolvency courts) may be recognised in the Ukraine: (a) if there is a relevant international agreement between the respective foreign jurisdiction and Ukraine (no such agreement exists between Ukraine and the UK. However, Ukraine has such treaty with the Russian Federation and some other republics of the former USSR); or (b) based on the reciprocity principle with a foreign jurisdiction (i.e., in the absence of the relevant agreement, Ukraine will recognise court judgments of the particular foreign jurisdiction if Ukrainian court judgments are recognised in such jurisdiction). From February 2010, Ukrainian procedural legislation presumes that "in the absence of the relevant international agreement, a reciprocity exists unless proved otherwise". We note that the described provisions have not yet been tested in practice.

Hungary

Key Elements:

- Court assisted liquidation proceedings
- Bankruptcy proceedings based on a composition agreement
- Civil and criminal law liability issues
- Recognition of foreign procedures within and outside the EU

Introduction

In Hungary, the relevant provisions on bankruptcy and liquidation proceedings, i.e. applicable in the event a company is insolvent or is in financial difficulties is regulated by the Act XLIL of 1991 on Bankruptcy and Liquidation Proceedings (the "Bankruptcy Act"). The insolvency of credit institutions and insurance companies is addressed in separate laws the analysis of which is beyond the scope of this note. Please note that a substantially amended Bankruptcy Act has been passed by the parliament in 2009 and the new provisions of the Bankruptcy Act entered into force as of 1st September 2009.

Liquidation and Bankruptcy (reorganisation) Proceedings

Under Hungarian law, liquidation proceedings are proceedings initiated by a creditor of the company or by the debtor company itself, in a situation where the company is, or is considered by its creditor to be, insolvent and unable to perform its financial obligations. The liquidation proceedings end by the dissolution of the debtor company with the sale proceeds of the debtor's assets distributed among its creditors in accordance with the waterfall set out in the Bankruptcy Act. In bankruptcy (reorganisation) proceedings the debtor requests relief from its financial obligations temporarily in an attempt to seek a composition agreement with its creditors. The goal of the bankruptcy procedure is to reorganise the debtor company in order to enable it to continue its business operation.

Bankruptcy proceedings are rarely applied by companies in Hungary. Although the amendments adopted in 2009 were made to the applicable legislation in particular with the purpose of facilitating the increased use of this technique vis-à-vis liquidation proceedings, according to the statistics the number of bankruptcy proceedings initiated since the implementation of the reform has remained very low. Experts are convinced that it is still easier to liquidate a company in financial difficulties and to establish a new company than to rescue and reorganise it in bankruptcy proceedings.

Liquidation proceedings are typically lengthy (the liquidation of a company may last for up to two years), formal and expensive with an uncertain outcome for the creditors with often the majority of them receiving nothing. Uncertainties also arise from the different practices of the liquidators.

Bankruptcy (reorganisation) Proceedings (cs deljárás)

Summary

In bankruptcy proceedings, creditors may compromise their rights (for example, by extending the repayment date, write-off a part of their claims, converting some of it to equity, or converting cash pay interest into PIK interest). Bankruptcy proceedings are designed to arrange for the reorganisation of an insolvent company (or a company in financial difficulties) with the consent of most of its creditors by granting it a moratorium (resulting in the temporary suspension of its payment obligations with a view to reorganising its debt in a way that will enable it to continue its business operations as a going concern). The composition scheme will be compulsory for, and could be enforced against all creditors of the debtor company, even if not all of the creditors have consented to it, subject to the necessary ratio of creditors consenting to such composition scheme.

Creditors and the debtor company are free to agree on, and formulate the terms of, the composition agreement. In particular, but not limited to, creditors or third persons have the right to (a) assume the debts of the company; (b) acquire certain assets of the company, and/or (c) guarantee the liabilities of the company.

However, it has to be carefully considered when formulating the composition agreement, that it may not contain less favourable conditions in respect of the non-consenting creditors than to the creditors granting consent to the agreement (however, it does not mean that it has to contain the same conditions for all creditors).

Overview of the Procedure

The managing directors of the debtor company as well as a creditor of the debtor company are entitled to file petition for bankruptcy proceedings at court. A creditor is entitled to initiate bankruptcy proceedings if he was also entitled to initiate liquidation proceedings, however he opts for seeking satisfaction of his claims by the way of bankruptcy proceedings. It is important to note that the creditor could file petition for bankruptcy proceedings only if both (i) the debtor company and (ii) the shareholders'/members' meeting consent to it, i.e. only with the cooperation of the debtor company.

It is not a precondition that the company filing petition for bankruptcy proceedings is insolvent.

Commencement of bankruptcy proceedings

A bankruptcy proceeding may be initiated (a) by the debtor company itself or (b) by a creditor of the debtor company.

(a) Upon filing a petition for bankruptcy proceedings at court by the managing directors of the debtor company, a temporary payment moratorium is automatically granted to the company by the court (i.e. no voting test is applied). The decision of the court is published within 1 business day of the petition submission on the website of the Company Gazette. Within 5 business days of receiving the petition, the court examines the petition whether it complies with the formality requirements set out in the Bankruptcy Act. If the petition has not been provided in the required form and subsequently the debtor company fails to provide the requisite supplementary submission within 5 business days of it being requested by the court, the court may reject the petition. The day the court publishes its decree approving the petition (the "Decree") is considered as the commencement date of the bankruptcy proceedings.

(b) In cases where a creditor files for bankruptcy proceedings to be initiated against a debtor company, the court also has a 5-business day deadline to review the petition and issue a supplementary submission request if the petition does not comply with the relevant formality requirements. Upon receipt of the appropriate creditor petition which is satisfactory to the court in both form and substance, the petition is delivered to the debtor company by the court within 5 business days. The debtor company is obliged to submit certain additional documents to the court and declare, among others, whether it acknowledges or contest the claim of the creditor within 15 days. Should the debtor company contest the claim or evidence its repayment or fail to provide the requested documents, the court will reject the petition of the creditor. Otherwise, upon the expiry of the 15 days deadline the court issues its Decree on the commencement of the bankruptcy proceedings and arranges for the publication of the Decree in the Company Gazette.

In the Decree, the court (i) confirms the moratorium and (ii) appoints an administrator (the "Administrator").

Moratorium

(a) The moratorium begins from the date of the Decree and lasts for at least 90 days and maximum 365 days. In case of the debtor company initiated bankruptcy proceedings referred to in point (a) above this means that the temporary payment moratorium is converted into a "normal" moratorium. Extension of the moratorium may be available: (i) for an additional 180 days if a simple majority of the secured creditors (by reference to the value of their claims) and a simple majority of the unsecured creditors (by reference to the value of their claims) give their consent thereto; or (ii) for 365 days if 75% of the secured creditors (by value of their claims) and 75% of the unsecured creditors (by value of their claims) give their consent thereto.

(b) During the period of the moratorium,
   (i) the company is prohibited from performing any of the payment obligations, which existed at the time of the commencement of the bankruptcy proceedings with a few exceptions regarding salaries, VAT and social security payments and repayment of amounts erroneously transferred to the company's accounts; however, the creditors' claims shall earn interest;
   (ii) the performance of any of the company's payment obligation is subject to the Administrator's countersignature;
   (iii) the creditors cannot set off any of their claims against the debtor company;
   (iv) no prompt collection right can be exercised by any of the creditors in respect of the company's bank accounts;
   (v) the execution proceedings of money claims against the company shall be suspended;
   (vi) the secured creditors are not entitled to enforce any security interest created for their benefit;
   (vii) the debtor company may only assume further obligations (including debt obligations) with the Administrator's prior written consent;
   (viii) the agreements concluded with the company cannot be terminated for the reason that the company is not paying its debt as they fall due during the course of the moratorium; furthermore
   (ix) the legal consequences associated with any non-performance or late performance of money payment obligations shall not apply.

(c) Creditors have to report (i) their existing claims to the debtor company and the Administrator within 30 days of publication of the Decree, and (ii) their claims arising after the commencement of the bankruptcy procedure within 3 business days of publication of the Decree.

Administrator

(a) The court designates a professional, independent Administrator. The Administrator has the power to monitor the company's business activities to protect the creditors' interests (please refer to its rights indicated in point (e) under title "Moratorium" above). He is entitled to confirm the company's new obligations, provided that such obligations are necessary for the company's reasonable operation and the conclusion of the composition scheme.

(b) The debtor company and the Administrator are in charge of the registration and classification of the creditors' claims.

(c) The Administrator shall take part in the negotiations of a reorganisation programme and of the composition proposal. The Administrator has to consent to the composition agreement as well.

(d) The Administrator has the right to (i) challenge any contract entered into without its prior consent or countersignature and (ii) initiate any proceedings for the reimbursement of any amounts paid by the company contrary to the prohibitions set out in the Bankruptcy Act (please refer to point (e) under title "Moratorium" above).

(e) The fee of the administrator is 0.5-2% of the value of the assets of the company but at least HUF 500,000 (approximately EUR 2000).

Creditors' meeting on composition agreement

(a) Within 45 days of the commencement of the bankruptcy procedure, the company has to arrange a meeting to negotiate a composition agreement to which all known creditors and the Administrator shall be invited by delivering a composition proposal and the programme aimed to restore (preserve) solvency.

(b) At the creditors' meeting on the conclusion of the composition agreement each creditor (i) having reported its claim within the deadline set out in point (f) under title "Moratorium"; (ii) having paid the applicable registration fees; (iii) whose claim have been registered as acknowledged or not contested claims and (iv) the amount of such acknowledged or not contested claim is HUF 100,000 (approx. EUR 370) or less than HUF 100,000 (approx. EUR 370) is entitled to one vote. Classes of creditors are construed on the basis of being secured or non-secured creditors.

However, claims (i) where the beneficiary of which is a creditor being the sole member of the debtor company or a creditor with majority influence in the debtor company or a creditor forming a "recognised" or a "de facto" group of companies under Act IV of 2006 on Business Associations (the "Companies Act") with the debtor company; and (ii) arising from an assumption of debt by the debtor company less than 180 days before filing for bankruptcy or the beneficiary of which is a creditor to whom the debtor company assigned any of its claims less than 180 days before filing for bankruptcy, can be taken into account only up to 25% of the amount of the relevant claim when calculating the number of votes.

(c) According to the voting test applicable in respect of the composition scheme, such composition scheme is achieved if (i) a simple majority of the secured creditors and (ii) a simple majority of the unsecured creditors give their consent thereto.

The composition agreement

If a composition agreement is concluded with the consent of the proportion of the creditors specified above, the composition agreement shall also apply to non-consenting creditors who are otherwise entitled to participate in the composition agreement, or failed to take part in the conclusion of the composition agreement in spite of having been properly notified in relation to the creditors' meeting. Under the composition agreement the creditors or third parties have the right, amongst others to assume the debts of the company; acquire certain assets of the company, and/or guarantee the liabilities of the company. The composition agreement may not contain less favourable conditions in respect of the non-consenting creditors than to the creditors granting consent to the agreement.

Closing of the bankruptcy procedure

The managing directors of the company have to notify the court on the result of the negotiations on the composition agreement within 5 business days of the creditors' meeting, or in case of extension of the moratorium 45 days before the expiry date thereof at the latest.

(a) If no agreement has been reached or such agreement does not comply with the applicable provisions of the Bankruptcy Act, the court will establish the insolvency of the company ex officio, i.e. in case of failure of the bankruptcy procedure, it will automatically turn into liquidation proceedings.

(b) If the composition agreement complies with the provisions of the Bankruptcy Act, the court shall confirm it and discharge the bankruptcy proceedings by decree. Although it is not stipulated explicitly in the applicable legal norms, on the basis of recent case law it can be concluded that once the decree of the court becomes final and non-appealable, the creditors will have the right to challenge the composition agreement only, if there was a mistake, deceit or duress, or the contractual terms were manifestly disproportionate.

(c) Upon the publication of the decrees referred to in points (a) and (b) above, the moratorium is terminated.

Liquidation Proceedings (felszámolási eljárás)

Summary

Pursuant to the Bankruptcy Act, liquidation proceedings will be commenced if the competent court establishes that the company, against which a request for liquidation has been submitted, is insolvent. Under Hungarian insolvency law a cash-flow test is applied in determining whether a company is insolvent, i.e. no balance sheet test applies. The court declares a company insolvent if any of the following conditions applies:

(a) the debtor company failed to comply, within 15 days from the due date, with a contractual obligation which obligation was not challenged or was explicitly acknowledged by the debtor company and the debtor company did not pay its debts following the respective payment notice by the creditor; or

(b) the debtor company failed to pay its debts based on a final and binding judicial decision within the deadline set forth therein; or

(c) the enforcement procedure against the debtor company has proven to be unsuccessful; or

(d) the debtor company failed to comply with its obligations set forth in the composition agreement concluded during a bankruptcy procedure; or

(e) the court has terminated the bankruptcy procedure; or

(f) in the procedure initiated by the debtor company or the receiver (the person responsible for the winding-up procedure, i.e. the solvent dissolution (végelszámolás)) the amount of the company's debts exceeds the value of its assets, or the company could not (or it is foreseeable that it will not) repay its debts when due, and the members/shareholders of the company do not undertake to provide funds for the payment of such debts when they become due.

The liquidation proceedings could be initiated by a creditor, the debtor company against itself, or by the receiver referred to in point (f) above. Directors of the company have no mandatory duty to file for liquidation proceedings. However, directors of a limited liability company or a company limited by shares are required to convene a shareholders' / members' meeting according to the Companies Act "without delay", when they learn that (i) the company faces the possibility of becoming insolvent, and/or (ii) the company is unable to meet its payment obligations; and/or (iii) the assets of the company are worth less than its liabilities. In case of limited liability companies such members' meeting has to be also convened if the amount of the company's equity decreases below 50% of the registered capital of the company due to its losses. In case of companies limited by shares such percentage is 75% of the registered capital, furthermore the same mechanism applies if the company's equity decreases below HUF 5,000,000 (approx. EUR 17,000). At the meeting the members / shareholders may decide (amongst other things) to wind up the company by commencing liquidation proceedings.

Overview of the Procedure

If any of the conditions listed above applies, the court orders liquidation within 60 days of receipt of the request to commence liquidation proceedings by issuing a court decree. The liquidation order is published in the Companies Gazette when it becomes final and non-appealable. The date of the publication of such an order is the commencement date of the liquidation proceedings.

Liquidator

In the court decree, the court also appoints a liquidator from the official list of liquidators. It is important to note that the concept of an administrative receiver (an official acting on behalf of the secured creditor and enforcing security) does not exist under Hungarian law.

Claims of creditors

Creditors are required to report their claims to the liquidator within 40 days from publication of the liquidation order in the Companies Gazette. During liquidation, all creditors' claims are to be satisfied to the extent possible and in the order prescribed by the Bankruptcy Act. In the event a creditor fails to report its claim within the 40-day period, it may report the same to the liquidator within 180 days from publication of the liquidation order. These latter claims shall be satisfied if sufficient funds remain following the settlement of the debts recorded within 40 days of the date of the publication of the order of the liquidation proceedings. Any claim reported after the 180-day period will be automatically rejected by the liquidator.

Upon reporting the claim, the creditor is required to pay to a specific bank account a so-called registration fee, which is currently set at 1% of the amount claimed and a maximum of HUF 200,000 (approx. EUR 740). The registration fee paid by a creditor is considered as the claim of such creditor against the debtor company and is ranked under item (f) (i.e. "other claims") in the sequence described under title "Ranking of creditors' claim" below.

Creditors' Committee

For the purpose of establishing a creditors' committee, the liquidator shall convene all registered creditors within 75 days following the date of publication of the order of liquidation. At least one-third of the creditors (by number), having at least one-third of the aggregate of registered claims (by value) may form a committee the ("Creditors' Committee") at or after meeting of the creditors convened by the liquidator. The liquidator shall inform the Creditors' Committee (i) within 15 days' of the conclusion of any agreement falling out of the ordinary course of business of the debtor company and of the termination of any existing agreements and (ii) of the financial status of the debtor company on a quarterly basis. The Creditors' Committee has limited rights to control the activity of the liquidator. Furthermore, if the company intends to continue its activities in the course of the liquidation, the liquidator has to acquire the consent of the Creditors' Committee to do this.

Direct enforcement of claims of secured creditors

A secured creditor cannot enforce its security if liquidation proceedings have been initiated, save for a security deposit (a financial collateral under directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements implemented in Hungary, used to encumber debt and equity securities, and money), which provides direct enforceability, i.e. if the security deposit is enforced by the secured creditor within three months from the commencement date of the liquidation proceedings, then the deposited asset will not form part of the insolvency pool of the insolvent company.

Ranking of the creditors' claim

On liquidation, mortgages, fixed and floating charges and other pledges have preferential ranking. In case of mortgages and fixed (as opposed to floating) charges, if such security interests were created before the commencement date of the liquidation proceedings, the liquidator will only deduct the costs of (i) the safe-keeping and (ii) the sale of the charged asset, as well as (iii) the statutory fee of the liquidator from the purchase price obtained from the sale of the charged asset. The remaining amount will be used promptly after the sale for the satisfaction of the claims secured by the charges in question (i.e. those proceeds shall transfer to the secured creditor(s)). In case of floating charges, 50% of such proceeds shall be immediately transferred to the creditor being beneficiary of the floating charge. The remaining half will form part of the insolvency estate of the debtor company, therefore the outstanding claim of the creditor being beneficiary of the floating charge will be satisfied in accordance with the sequence below.

Other types of security, such as guarantees, surety and security assignments do not have such preferential ranking and consequently the beneficiaries of such security will be ranked under item (f) "other claims" as set out below. Creditors' claims will be satisfied in the following order:

(a) costs of liquidation (e.g. unpaid wages, taxes and employer contribution obligations, winding up costs and liquidators' fees);

(b) claims secured by floating charges up to the value of the encumbered asset, if such security interests were created before the starting date of the liquidation procedure (if not covered already by the 50% of the proceeds, see above);

(c) alimonies, life-annuity payments, compensation benefits, supplements to mining earnings payable, etc;

(d) (with the exception of claims based on bonds) other claims from private individuals not originating from economic activities (in particular, claims resulting from insufficient performance or compensation for damages, also including guarantee obligations ordinarily expected in the given trade, calculated by the liquidator), claims of small and micro companies as well as small-scale agricultural producers;

(e) social insurance debts and overdue private pension fund membership fees, taxes and public debts collectable as taxes, as well as water and sewage connection charges;

(f) other claims;

(g) irrespective of the time and grounds of occurrence, default interest and late charges, as well as surcharges and debts;

(h) (with the exception of claims for wages the amount of which is less than two times the amount of the minimum salary and than six month average salary) claims of (1) the member (shareholder) of the company having majority influence, (2) the manager of the company, (3) a leading employee of the company, (4) the close relatives and/or the cohabite of the persons referred to in points (1)-(3), (5) another company under the major influence of the company, (6) as well as claims outstanding under the contracts of the company without a consideration.

Selling the assets of the company

The liquidator will dispose of the company's assets through public sales at the highest price that can be obtained on the market. The liquidator must affect the sale by way of tender or auction. Unless otherwise provided for by the Creditors' Committee, the sale shall be commenced within 100 days of publication of the liquidation.

Right to challenge

Any creditor of an insolvent company or the liquidator has the right to challenge transactions concluded by such insolvent company which is of a type falling under any of the criteria set out under subparagraphs (a)-(c) below. The persons referred to above have the right to challenge such transactions within 90 days from the date of becoming aware of the existence of such transactions, but in any event within 1 year from the date of publication of a court order relating to the commencement of the liquidation proceedings. The types of transactions open to challenge are the following:

(a) Contracts concluded or legal declarations made by the insolvent company within five years of the date preceding the date when a competent court received a petition for the initiation of liquidation proceedings or at any time thereafter, if such contract or legal declaration resulted in the decrease in the value of the insolvent company's assets, and the intent of the insolvent company was to defraud any or all of the creditors, and the contracting party, or beneficiary of the legal declaration had or should have had knowledge of such intent;

(b) Contracts concluded or legal declarations made by the insolvent company within two years of the date preceding the date when a competent court received a petition for the initiation of liquidation proceedings or at any time thereafter, if the subject matter of such contract or legal declaration is (A) a free asset transfer by the insolvent company; (B) an undertaking by the insolvent company in respect of its assets for no consideration; or (C) an arrangement resulting in evidently disproportional benefit in value to the contracting party;

(c) Contracts concluded or legal declarations made by the insolvent company within ninety days of the date preceding the date when a competent court received a petition for the initiation of liquidation proceedings or at any time thereafter, if the subject matter of such contract or legal declaration is to grant preference to any one creditor, in particular an amendment of an existing contract for the benefit of such creditor, or provision of collateral to an unsecured creditor.

The liquidator, acting on behalf of the insolvent company, is entitled to seek to recover within the time periods referred to in paragraph (a) above, any service rendered by the insolvent company within 60 days of the date preceding the date when a competent court received a petition for the initiation of liquidation proceedings or at any time thereafter, if the provision of such service resulted in a preference to any one creditor and was not made in its normal course of business. In particular payment of a debt prior to its original maturity is considered as granting preference a creditor.

If the insolvent company does not receive compensation for the provision of a guarantee, the creditors or liquidator of the insolvent company may contest the guarantee agreement if it was concluded within one year prior to the commencement of the liquidation proceedings.

Composition scheme

During the liquidation proceedings the company and its creditors are entitled to enter into a composition scheme, in order to restore solvency. The court, within 60 days of the request of the debtor, has to hold a hearing, where the debtor, the creditors and the liquidator have to be invited. The debtor has to prepare a composition proposal and a reorganisation plan in advance to the hearing.

Under the composition agreement the creditors and the debtor may agree on the sequence of satisfying the claims, amendments of the maturity date of the claims, release of a certain portion of the debts of the company, and any other factors that are deemed essential by the company and the creditors for the purpose of restoring the company's solvency.

The creditors have to vote in classes, as specified under title “Ranking of the creditors' claim” above. Creditors in classes (a) and (c) are not entitled to vote. The beneficiaries of any pledge/charge/mortgage are also entitled to vote in respect of the composition scheme until their claims are satisfied. The calculation method of voting rights is intended to mirror the method applicable on bankruptcy, i.e. creditors whose claims are of the amount of HUF 100,000 (approx. EUR 370) or less than HUF 100,000 (approx. EUR 370) are entitled to one vote. Consent to the composition scheme shall be considered being granted if (1) more than half of the creditors (by number) in each class agree, provided that (2) the aggregate of the claims of creditors giving consent is equal or exceeds (by value) two-thirds of the claims of all creditors entitled to vote.

If the solvency of the company has been restored and the composition agreement complies with the provisions of the law, the court shall discharge the liquidation proceedings by decree.

Closing the liquidation procedure

At the end of liquidation or at latest at the end of the second year from the starting date of liquidation, the liquidator must prepare the final insolvency balance sheet and other documents and deliver them to the court.

The court shall distribute the insolvency balance sheet and the proposal for the distribution of assets to the creditors within 30 days of receipt. Any creditor may raise an objection in writing concerning the insolvency balance sheet or the proposal for the distribution of assets within 30 days of the date of receipt. Failure to observe this time limit shall constitute forfeiture of rights. The court will set a date for hearing to which the creditor(s) raising the objection and the liquidator shall be summoned. The court shall resolve whether to sustain or reject the objection after the hearing. The court's decision for the rejection of the objection cannot be appealed.

Liability issues

The Companies Act provides that if the management of a company can (or should) reasonably foresee that the company is likely to become insolvent (a situation is considered of having the possibility of becoming insolvent, when the directors of the company were or should have been able to foresee that the company will not be able to satisfy its existing liabilities as they fall due), the directors/management are under an obligation to prioritise the interests of creditors, therefore they are personally liable for those claims of the creditors which were not satisfied in the course of the liquidation proceedings. Under the Companies Act, directors have to manage the company with due care and diligence, as generally expected from persons in similar positions and give priority to the interests of the company. This general rule is superseded when the company is faced with the possibility of becoming insolvent, in which case the director has to give priority to the creditors' interest.

Pursuant to the Bankruptcy Act any creditor or the liquidator of a company may bring an action in the course of the liquidation proceedings in order to request the court to establish that the former directors of the insolvent company failed to properly prioritise the rights of creditors. This action could be filed only in respect of those directors who were in office (i) during the period of three years prior to the commencement of liquidation proceedings and (ii) after the point in time at which it was reasonably foreseeable that insolvency could occur -i.e. the point in time at which the duties of the directors become duties to prioritise the interests of creditors. The creditors or the liquidator have to prove that the failure by the directors to properly prioritise the interests of creditors resulted in a depreciation of assets of the insolvent company and thus there is a direct causal link between the damage the creditors suffered and the improper actions/decisions of the directors.

The creditors of the company become entitled to claim that the company provides them with a security interest capable of being expressed in monetary terms in order to ensure the satisfaction of the creditors' claims, e.g. a certain amount of money to be held in escrow by the relevant court or a financial institution, securities, bank guarantee, etc. In cases where the liquidation proceedings haven been successfully completed, such security interest is distributed among the creditors in accordance with the creditors' waterfall generally applicable. The member of the company having majority influence is obliged to pay to the creditors such monetary security interest as a surety in case the company fails to do so.

In case the insolvency estate of the debtor company is not sufficient for the satisfaction of the creditors' claims, the creditors or the liquidator may sue the debtor company's former director and request the court to oblige him to pay the creditors' claims to the extent the claims are not satisfied.

The Bankruptcy Act also establishes liability for shadow directors on the same basis. In this context the Bankruptcy Act extends the definition of "director" to any person who had actual influence on the decision making of the directors of the insolvent company. Determining whether a person or persons is considered to be a shadow director(s) on the basis of the above is in the competence of the court and the Bankruptcy Act does not set out any clear guidelines as to when the test would be met.

Several articles of the Act IV of 1978 on Criminal Law (the "Criminal Code") establish criminal liability in relation to liquidation and/or bankruptcy proceedings. An executive officer of a company (i) violating his reporting, bookkeeping, auditing, inventory or other obligation to provide required information in accordance with the Accounting Act, the Bankruptcy Act or any other applicable laws and thereby impeding transparency of the company's financial situation (violation of accounting regulation); (ii) diminishing the value of the company's assets by e.g. by hiding, damaging, destroying any of the assets, concluding fictitious transactions or by any means contrary to prudent management after the point in time when insolvency of the company is foreseeable and thereby hindering the company's creditors from obtaining satisfaction of debt out of its assets (bankruptcy crime); (iii) concealing the company's assets and thereby hindering the company's creditors from obtaining satisfaction of debt out of its assets (concealment of assets); (iv) deceiving the members of the company by providing incorrect data and information concerning the financial position of the company or hiding such data (illegal conduct of an executive officer of the company); (v) concealing the whole or any part of the company's equity capital (concealment of equity capital); or (vi) assisting in hiding relevant data in connection with the company or an authorised representative of the company and thereby ensuring that the company or the authorised signatory cannot be located (failure to comply with economic data supplying obligation) may be held criminally liable by Hungarian courts.

Out of the specific, rather liquidation and/or bankruptcy related crimes described above, the Criminal Code contains general provisions regarding such crimes as fraud or misappropriation which might be also of relevance in an analysis dealing with the criminal liability of executive officers of a company in case of a bankruptcy or liquidation scenario.

According to other provisions of the Bankruptcy Act liability of holding companies could be also established in certain cases within an insolvency scenario. In respect of the liquidation of a company under control by a "qualified majority" under the Bankruptcy Act (for this purpose a holding company possessing at least 75 per cent of voting rights, either directly or indirectly), or in respect of a single member company, the controlling party or the sole member could be held responsible for the company's liabilities to the extent the insolvency estate did not cover such liabilities. Any such liability would be determined by a court only if creditors were able to demonstrate that the member or controlling party had actual influence on the decision making of the insolvent company and carried out a permanently detrimental business policy.

Recognition of Foreign Proceedings

Within the European Union

The Council Regulation (EC) No 1346/2000 of 29 May on liquidation proceedings (the "Insolvency Regulation") has entered into force in Hungary as of 1st May 2004 when Hungary joined the European Union. Under the Insolvency Regulation, recognition of foreign liquidation proceedings listed in the Insolvency Regulation would be automatic.

Furthermore, Council Regulation (EC) No. 44/2001 of 22 December 2000 (the "Enforcement Regulation") is also applicable in Hungary. Therefore if a type of procedure governed by the law of a member state which, because of its complex or ambiguous nature, cannot be unequivocally held to be under the scope of the Insolvency Regulation is likely to be also recognised by Hungarian courts on the basis of the Enforcement Regulation (e.g. scheme of arrangement).

Outside the European Union

Regarding recognition of foreign proceedings against debtor companies whose centre of main interest is outside the European Union, the provisions of the Law-Decree 13 of 1979 on Private International Law (the "Private International Law Act") apply. Pursuant to the Private International Law Act any final and non-appealable decision issued by a foreign court in a matter over which Hungarian courts do not have exclusive jurisdiction is recognised and enforceable in Hungary.

Special provisions apply in the event liquidation proceedings or other similar procedure are initiated against a foreign company having its registered seat outside the European Union and having a branch incorporated in Hungary. The Hungarian branch may be involved in liquidation proceedings initiated against the foreign parent company abroad only if any international treaty provides so or reciprocity is applicable between the two countries. If no such international treaty or reciprocity is applicable, the relevant Hungarian court orders liquidation of the branch ex officio.

In the event the foreign parent company becomes insolvent in connection with its business activities carried out through its Hungarian branch and no international treaty or reciprocity is applicable in the relation of the two countries in respect of liquidation proceedings, creditors may request liquidation of the branch from the relevant Hungarian court.

Russia

Key Elements:

- Impact of insolvency on creditors
- Priority of claims
- Prior transactions
- Liabilities of the management and shareholders

Introduction

Most of the legislation regulating the insolvency of corporate entities in Russia is contained in the Federal Law No. 127-FZ "On insolvency (bankruptcy)" of 26 October 2002 (the "**Insolvency Law**") which was significantly amended at the end of 2008 and in the middle of 2009. The insolvency of banks and other credit institutions which are subject to a special regime are beyond the scope of this note.

Applicability of Russian insolvency proceedings

Russian insolvency proceedings can generally be commenced only in relation to a Russian registered company. It is also possible that a Russian court would recognise decisions on insolvency proceedings in relation to a foreign entity issued by a foreign court (e.g. a decision of a foreign court restricting the disposal of property located in Russia and owned by a foreign entity against which bankruptcy proceedings had been commenced outside Russia). Recognition by the Russian court of a decision of a foreign court may be either on the basis of an international treaty (although at present there are no treaties relating to insolvency to which Russia is a party) or, in the absence of such a treaty, on the basis of the principle of reciprocity (although there is no established court practice on this point).

Bankruptcy hearings take place before the local arbitrazh court (the "insolvency court") in the area where the company is registered, but decisions of that court may be appealed to courts of higher instance.

Measures to prevent bankruptcy

If a company becomes distressed (see "Signs of bankruptcy"), the founders (participants) are to take measures (upon agreement with the company) to restore the company's solvency. The only measure specified by law is rehabilitation by way of provision of financial assistance in an amount sufficient to satisfy the payment obligations of the company to prevent its bankruptcy and restore its solvency.

The regime of rehabilitation is not sufficiently developed and is not usually used in practice.

In Russia there is no concept of a sale of a distressed business to a "newco" on a pre-agreed basis, free of residual liabilities which are left behind in the old structure prior to the commencement of bankruptcy proceedings (generally known in other jurisdictions as a "pre-pack"). A sale of a company's assets prior to instigation of bankruptcy proceedings may be challenged as a "suspicious" or "preferential" transaction.

Is a standstill agreement available outside bankruptcy?

Under Russian law so called standstill agreements, which may be available in other jurisdictions for the purposes of efficient restructuring, or any similar arrangements entered into outside bankruptcy proceedings and introducing a moratorium on enforcement of creditors' claims and security against a Russian company suffering financial difficulties are unlikely to be enforceable, unless the terms of each relevant agreement under which the relevant debt obligations have arisen have been formally amended.

Main stages of Russian insolvency proceedings

There are five possible stages of insolvency proceedings that may be applied against a Russian company:

Supervision

- Supervision is the first compulsory stage of insolvency proceedings. It involves the appointment of an interim administrator by the insolvency court whose primary aim is to preserve the company's assets while conducting a financial audit of the company to determine whether the company may be restored to solvency. It includes an initial registration of creditors' claims.
- The interim administrator is approved by the insolvency court following nomination by the petitioner or by selection from a list of candidates presented by the self-regulatory organisation of insolvency administrators (the "**SRO**") proposed by the petitioner in its bankruptcy petition.
- During the supervision stage the company's management remains in place (although with limited authority).
- During the supervision stage the first creditors' meeting must be held which, among other things, should decide on the next stage of insolvency proceedings.
- Upon commencement of supervision, payment of creditors' claims which arose before opening of the insolvency proceedings, and actions or transactions aimed at satisfaction of such claims, are subject to restrictions most of which are extended to the further stages of insolvency (see "*What impact does commencement of insolvency proceedings have on creditors' rights?*").
- The supervision stage can last up to 7 months.

Financial rehabilitation

- Financial rehabilitation which is not a compulsory stage of insolvency proceedings is instigated by the insolvency court (i) at the petition of the first creditors' meeting, and, in the absence of such petition (ii) at the petition of the company's shareholders or other persons willing to put up collateral for the company's debts.
- In the course of rehabilitation a debt repayment schedule must be drawn up under which (i) all registered claims are to be satisfied according to the statutory order of priority no later than 1 month prior to the end of the stage, and (ii) first and second priority claims are to be satisfied within six months from the date of commencement of rehabilitation.
- Financial rehabilitation is primarily aimed at restoring the company's solvency and the satisfaction of creditors' claims in accordance with a debt repayment schedule.
- If financial rehabilitation is successful, the company emerges from the insolvency proceedings; if not, the insolvency court will move to liquidation unless, to the extent the length of financial rehabilitation allows, there are grounds to move to external administration (see "*External Administration*").
- If the debt on the debt repayment schedule was satisfied out of security provided by third parties, the claims of such security providers against the debtor may only be satisfied after termination of the bankruptcy proceedings (in the event the debtor's solvency is restored) or at the liquidation stage as a third priority claim (i.e. *pari passu* with other unsecured claims of creditors).
- Implementation of the debt repayment schedule and the plan for financial rehabilitation (which is drawn up if collateral supporting the debt repayment schedule was not provided) is supervised by an administrator.
- The administrator is approved by the insolvency court following nomination by the creditors' committee or selection from a list of candidates presented by the SRO proposed by the creditors' committee, but again, the company's management remains in place (although its authority is more limited than at the supervision stage).
- Financial rehabilitation can last no more than 2 years.

External administration

- External administration which is not a compulsory stage of insolvency proceedings is generally instigated by the insolvency court at the petition of the creditors' meeting. It involves the appointment of an external administrator to collect in debt, make an inventory of assets and prepare a plan for restoring solvency (to be approved by a majority of creditors voting at a creditors' meeting).
- The external administration commences if there is a real possibility of restoring the company's solvency within the set time limits, and when it succeeds the financial rehabilitation stage it may be commenced only if not more than 18 months have passed since the commencement of financial rehabilitation.
- The company's management is removed by the insolvency court and management power is vested in the external administrator.
- An external administrator is approved by the insolvency court by the same procedure as that applicable to financial rehabilitation.
- Subject to the limitation of the aggregate duration of financial rehabilitation and external administration mentioned below, external administration can last up to 18 months but may be extended by a further 6 months on the petition of the majority of registered creditors voting at a creditors' meeting.
- The aggregate term of the financial rehabilitation and external administration may not exceed 2 years.

Liquidation

- Liquidation is the last stage of insolvency proceedings.
- The company may generally enter into liquidation if the insolvency court determines that the company shows "signs of bankruptcy" and there are no grounds to (i) instigate any recovery stages of bankruptcy (i.e. financial rehabilitation and external administration); (ii) approve a voluntary arrangement; or (iii) terminate bankruptcy proceedings or dismiss a bankruptcy petition.
- In addition, the company may enter into liquidation if the creditors at the creditors' meeting:
  - petition at any stage of insolvency to have the company declared bankrupt and for the commencement of liquidation;
  - fail to approve the solvency plan within 4 months from the date of commencement of external administration;
  - reject the solvency plan and petitions for liquidation; or
  - on the basis of the report of the external administrator, fail to take either a decision resulting in termination of insolvency proceedings or a decision on commencement of liquidation, if (a) the insolvency court was petitioned for commencement of liquidation and (b) the maximum term for which the external administration can last has expired.

- Liquidation starts by declaring the company bankrupt and involves the appointment by the insolvency court of a liquidator to realise the company's assets and satisfy its debts in accordance with the statutory order of priorities.
- The liquidator is approved by the insolvency court by the same procedure as that applicable to the administrator in financial rehabilitation and replaces the management of the company.
- Upon commencement of liquidation, all debts are deemed due, all assets are consolidated in a pool comprising the bankrupt estate (although secured assets are accounted for separately within the pool) and all bank accounts are consolidated into a single account save for a "special account" which is to be established for the purposes of collecting proceeds from the sale of secured property.
- Upon commencement of liquidation, monetary claims and other claims on enforcement of the debtor's assets can only be made in the course of insolvency proceedings (save for creditors' current claims and claims on recognition of ownership rights, on compensation for moral damages (mental suffering), on recovery of property from unlawful possession of the debtor and on invalidation of transactions and application of the consequences of such invalidation which may be pursued outside of the insolvency proceedings).
- Liquidation lasts for up to 6 months, although it may be extended by a further 6 months.

A voluntary arrangement

- A voluntary arrangement can be entered into at any stage of insolvency proceedings.
- The creditors' meeting can petition for a voluntary arrangement upon approval by a majority of creditors whose claims are included in the register of creditors, and with the unanimous consent of those creditors whose claims are secured by a pledge or mortgage over the debtor's assets.
- To be legally binding a voluntary arrangement must be approved by the insolvency court and the court may approve it only if the unsecured claims of the first and second priority creditors and current claims are being satisfied.
- A voluntary arrangement binds the company and the creditors whose claims were included in the register of creditors (irrespective of whether they voted against such arrangement or did not vote).
- From the date of court approval of the voluntary arrangement, the insolvency proceedings terminate and the debtor is obliged to start repayment of creditors' claims in accordance with the repayment schedule set out in the voluntary arrangement.
- Existing security (in fact, only pledges or mortgages) over the debtor's assets is retained to secure claims of secured creditors under the voluntary arrangement, unless otherwise provided in the voluntary arrangement.
- The voluntary arrangement can be terminated only with respect to all creditors bound by the arrangement and arguably only in the case of the debtor's failure to perform, or a material breach, affecting creditors whose claims constituted at least 25 percent of all the registered creditors' claims as of the date of approval of the voluntary arrangement.
- If new insolvency proceedings are subsequently brought against the company, the creditors who entered into the voluntary arrangement will only have the right to claim for the amounts provided for under the voluntary arrangement.

Shortened insolvency proceedings

In certain cases (such as commencement of insolvency proceedings against a company during the process of its voluntary liquidation) the shortened insolvency proceedings apply.

If during voluntary liquidation of a company it appears that the value of the company's assets is not sufficient to settle its creditors' claims, the company's liquidator must file for its bankruptcy. In such circumstances the earlier stages of insolvency will not apply and the company is declared bankrupt and the liquidation stage of insolvency is commenced immediately after filing the bankruptcy petition, which significantly reduces the duration of the insolvency process.

As a result, in order to participate in the debtor's insolvency proceedings creditors should file their claims with the insolvency court within 1 month of public announcement that the company was declared bankrupt, and in order to be included in the register of creditors' claims, arguably within 2 months of such announcement. If creditors fail to file within the respective periods, they may not vote at creditors' meetings and the claims outside the register of creditors' claims will be satisfied after discharge of all registered claims.

How can insolvency proceedings be commenced?

Insolvency proceedings can be commenced at the petition of:

(i) a third party creditor having a monetary claim against the company confirmed by a court decision;

(ii) a government agency in respect of debts owed to the state budget (e.g., the tax and customs authorities); or

(iii) the company itself (based on the decision of its directors or shareholders).

Signs of bankruptcy

The company is treated as not being able to satisfy the monetary claims of its creditors (i.e. as showing "signs of bankruptcy") if the unpaid debt is overdue for at least three months from the date when they were due to be repaid.

Substantive tests

Generally, for the commencement of insolvency proceedings by a creditor or a government agency, the unpaid debt should be equal to or exceed RUR 100,000, be overdue by at least 3 months and the unpaid debt must have been confirmed by the court as well founded.

Petition by creditors

A creditor may petition for the debtor's bankruptcy from the date a court decision to recover debt owed by the debtor enters into force.

Petition by foreign creditors

For a foreign creditor the following ways of confirming its claim against a Russian debtor for the purposes of filing a bankruptcy petition are available
(i) obtaining a foreign court judgment;
(ii) obtaining a foreign arbitral award; or
(iii) obtaining a Russian court judgment by initiating proceedings directly in a Russian court.

If foreign creditors obtain a foreign court judgment or a foreign arbitral award confirming the claim against a Russian debtor, a bankruptcy petition against the debtor can be filed with a Russian insolvency court only upon recognition and enforcement of such judgment or award.

A foreign court judgment: as no international treaty on recognition and enforcement of foreign judgments exists between Russia and most foreign jurisdictions (such as the UK, for example), a foreign court judgement can be recognised only on the basis of the principle of reciprocity on a case by case basis. Although there are a few cases when Russian courts have recognised foreign court judgments on the grounds of reciprocity, this practice is far from being considered established.

A foreign arbitral award: to initiate bankruptcy proceedings on the basis of a foreign arbitral award confirming the claim, such award will need and to be, if granted in the territory of a contracting state, recognised and enforced in the Russian courts on the basis of the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards.

A Russian court judgment: as an alternative, foreign creditors may take proceedings against a Russian debtor in the Russian courts (provided that a Russian court has jurisdiction to consider such dispute) and a Russian court should accept jurisdiction unless a foreign court has already passed a judgement in a dispute between the same parties where the resolved claim concerned the same subject matter and the judgement had already entered into force. The Russian court should also dismiss a claim without a hearing on the merits (without prejudice) if a foreign court is already considering a dispute between the same parties on the claim concerning the same subject matter. If a Russian court has jurisdiction to hear a claim against the debtor, it would consider the claim on the merits and once the judgment enters into force, a bankruptcy petition may be filed by a foreign creditor with the Russian insolvency court.

Petition by government agencies

There is a separate regime for dealing with petitions by government agencies. An agency may petition for a company's bankruptcy:

- with respect to debts owed to the state budget or otherwise to the Russian Federation ("**Mandatory Payments**"), when 30 days have passed after (i) a relevant tax or customs authority took a decision to recover a Mandatory Payment by seizing the debtor's funds or other assets (when a claim is subject to uncontested proceedings); or (ii) a court decision to recover Mandatory Payments entered into force (when a claim is subject to court proceedings); or
- with respect to any other claims, when a court decision to recover the debt enters into force.

Petition by the company

Generally, the company **must** petition for bankruptcy within 1 month of it becoming evident that:

(i) the satisfaction of the claims of one or more creditors results in the company's inability to perform its payment obligations in full to other creditors;

(ii) the enforcement of claims against the company's assets will create significant difficulties or make it impossible for the company to continue operations;

(iii) the company (a) ceases to pay any part of its debts as they fall due on account of insufficiency of funds ("inability to pay") or (b) has insufficient value of its assets to satisfy its monetary liabilities ("insufficiency of assets"); or

(iv) in the course of a solvent liquidation of the company, either of the tests referred to in (iii) above is met (in which case a bankruptcy petition must be filed with an insolvency court within ten days of either of the tests being met).

If the relevant persons fail to file a bankruptcy petition in the cases provided above, they may be subject to an administrative and/or civil liability (see "*Liability of "controlling persons" for the insolvent company's debts*").

In addition, the company **may** petition for bankruptcy if bankruptcy is anticipated because of circumstances clearly evidencing its inability to perform its payment obligations to its creditors in accordance with their terms.

How long could it take to commence insolvency proceedings?

The court should decide on whether to accept a petition and instigate insolvency proceedings, or refuse or defer the acceptance of the petition within 5 (five) business days of filing a bankruptcy petition with an insolvency court. The insolvency court must accept the creditor's petition if the claim on its face satisfies the substantive tests referred to in "*Substantive tests*". Acceptance of a bankruptcy petition does not inevitably mean that substantive insolvency proceedings will be instigated against the company as the insolvency court should first hold hearings to verify whether the grounds for commencement of substantive insolvency proceedings are well founded.

Not earlier than 15 (fifteen) business days and not later than 30 (thirty) business days after acceptance of the bankruptcy petition, the insolvency court should hold hearings to verify whether the petitioner's claim is well founded.

If the insolvency court confirms that:

- in case of a creditor's claim, the claim is well founded, continues to meet the test referred to in "*Substantive tests*" and as of the date of court hearings remains outstanding; and
- in case of a debtor's claim, any of the tests referred to in "*Petition by the company*" are met,

it must rule on the commencement of substantive insolvency proceedings and instigate supervision (the first compulsory insolvency stage).

How creditors may find out that its Russian debtor has been put in insolvency proceedings?

Information on the commencement of substantive insolvency proceedings against Russian companies (starting from institution of the supervision stage) must be published by the insolvency administrator in a special Saturday edition of the newspaper "Kommersant" which may be viewed online.

In addition, the Unified Federal Register of Information on Bankruptcy (the "**Bankruptcy Register**") which is a publicly available register containing, among other things, information on Russian debtors against which insolvency proceedings have been commenced, was recently established on the basis of the web resources of the news agency *Interfax* and the information contained in such Register is accessible online. Information on insolvency proceedings and the auctions for sale of bankrupt debtors' assets must be published in the Bankruptcy Register starting from 1 April 2011.

It is also usually recommended to make a search with respect to bankruptcy petitions and/or claims filed against a Russian debtor on the website of the relevant local arbitrazh court in the area where the Russian debtor is registered.

What impact does commencement of insolvency proceedings have on creditors' rights?

Claims of creditors upon commencement of insolvency proceedings

Once insolvency proceedings are commenced (i.e. the supervision stage is instigated) the insolvent company can only discharge its claims that arose before the opening of insolvency proceedings in accordance with the statutory order of priorities. In particular, upon institution of supervision:

- Creditors' claims (other than current claims i.e. claims that arose after the opening of insolvency proceedings) may be presented only in accordance with the procedure prescribed by law;
- For the purposes of participation in bankruptcy proceedings and inclusion of creditors' claims in the register, claims which arose on or before the acceptance by the insolvency court of a bankruptcy petition are deemed to be automatically due and payable;
- Any debt recovery proceedings and steps to enforce against the company's assets are suspended (except where enforcement is sought under enforcement orders for employment claims, personal injury claims, claims for moral damages (mental suffering), claims for recovery of property from the debtor's unlawful possession and certain other claims);
- All claims for the purposes of inclusion in the register of creditors' claims are converted into roubles at the exchange rate set by the Central Bank of the Russian Federation (the "**Central Bank**") as at the date of commencement of the insolvency stage following the maturity of such claim. Arguably once the amount of the claim is fixed in roubles and included in the register of claims, it is not subject to further revaluation in any subsequent bankruptcy stage if the exchange rate changes;
- Interest on registered claims during supervision arguably does not accrue at all and during each other stage of insolvency accrues at the Central Bank refinancing rate;
- Enforcement of pledges and mortgages is prohibited at this stage.

Set-off

From the date of commencement of the first insolvency stage (supervision), set-off against the debtor's claims is prohibited if it would breach the statutory order of priority, or such discharge results in the preferential satisfaction of claims of one creditor over another. Such prohibition extends to any further insolvency stage.

Contractual subordination

Any contractual subordination in respect of a claim against an insolvent Russian company is unlikely to be effective.

Dividends

From the date of commencement of the insolvency proceedings, any distribution of profit to participants, the payment of dividends to shareholders and other payments to holders of issued securities is prohibited.

Debt to equity swaps

Although debt to equity swaps by way of exchanging a company's debts for newly issued shares outside insolvency were recently permitted by amendments to companies laws, such swaps are not available in the course of bankruptcy proceedings against the company. At the insolvency stages where the issue of additional shares by a debtor is allowed, such shares are to be paid for in cash only.

In any case claims of shareholders for the return of equity are repaid after satisfaction of any other creditors' claims.

Transfer of claims

Under Russian law there are no restrictions for the transfer of claims against a debtor by its creditor in the debtor's insolvency to any other creditor or person (including when such claims are already included in the register of creditors' claims).

Security enforcement

Once insolvency proceedings are commenced, there is a general moratorium on the levying of execution against the property of the insolvent company. Pledged assets are segregated from other assets and may not be sold without the consent of the secured creditor.

Secured creditors can enforce their security at the financial rehabilitation and external administration stages, but only through the insolvency court with a sale of such secured property to be conducted at an auction organised by an insolvency administrator or a specialised organisation.

Enforcement against the secured property will be allowed unless the debtor can prove that enforcement against its secured property would make it impossible to restore the debtor's ability to pay its debts.

Enforcement proceeds from the sale of the secured property are applied against the secured debt as provided in more details in "*Claims of secured creditors*".

How the sale of the secured property is conducted at the liquidation stage?

At the liquidation stage the secured property must be sold in the same way as at the early insolvency stages and must be offered for sale at two consecutive auctions with the sale price at the first auction to be approved by the insolvency court and with the sale price at the second auction to be 10% lower than the initial sale price. If the second auction fails, the secured creditor is entitled to appropriate the secured property at a value which is 10% lower than the offered sale price at the second auction. If within 30 days from failure of the second auction the secured creditor fails to appropriate the secured property, the secured property is to be sold by way of a public offer with a gradual decrease in the price.

At the liquidation stage proceeds from the sale of the secured property or the value of the secured property appropriated by the secured creditor are applied against the secured debt subject to the limitations on allocation of proceeds or value described below in *"Claims of secured creditors"*.

Creditors' rights

Creditors have a say on the key matters concerning the insolvency process by participating in the creditors' meetings.

Creditors' meeting

Generally the creditors' meeting has exclusive competence, among other things, on the following matters:

- to approve additional criteria for nominees for the positions of insolvency administrator at different stages of insolvency;
- to approve a voluntary arrangement to be submitted to the court;
- to determine what would be the next stages of insolvency (i.e. either to petition the court to declare the company bankrupt and commence liquidation or to proceed with pre-liquidation insolvency proceedings that may end up with the restoration of solvency of the company and termination of insolvency proceedings).

Claims

In order to participate and vote at the creditors' meeting, creditors should file their claims (accompanied with either the court decisions confirming the claim or any other documents confirming the grounds for the claim) with the insolvency court requesting to include their claims in the register of creditors' claims.

In bankruptcy proceedings only monetary claims (and not claims against non-cash assets) against the debtor can be filed with the insolvency court and can be included in the register of creditors' claims.

The claims are included in the register on the basis of an insolvency court's ruling held after the insolvency court verifies the grounds for such claims and confirms that the claim is substantiated. As a result, while a loan granted before commencement of the insolvency process is automatically accelerated, only a debt that has been confirmed by an insolvency court ruling can be recorded in the register of creditors' claims, thereby entitling the relevant creditor to attend and vote at creditors' meetings during that stage. If the claim under a loan is not submitted to the insolvency court within the set period of time, the lender can register its claim (and participate in creditors' meetings, etc.) only at the next stage of insolvency when its claim is included in the register of creditors' claims.

The register is closed to new filings of claims within 2 months of public announcement of the company's bankruptcy and the commencement of liquidation.

How do creditors vote at the creditors' meeting?

Creditors vote at the creditors' meeting in proportion to their registered claims (in each case, excluding the amount of any claim for fines, penalty interest, damages and other financial sanctions). Decisions are generally adopted by a simple majority of votes of creditors attending the meeting (provided that not less than half of the registered creditors by claims were present at such meeting), although decisions on certain matters must be adopted by a majority of the total number of registered votes (e.g. on commencement of further stages of insolvency and extension of the term of such stages, on conclusion of a voluntary arrangement).

The decision of the majority creditors will be binding on the minority creditors and the company cannot influence any such decision. The validity of decisions can be challenged in a court.

Voting rights of secured creditors

Under the amended Insolvency Law, secured creditors have been expressly granted a right to vote at a creditors' meeting during:

- supervision; and
- financial rehabilitation and/or external administration if the secured creditor decided against the sale of secured property during these stages or if the insolvency court rejects the sale of secured property on the enforcement of the relevant pledge or mortgage.

Secured creditors that do not have a voting right can still participate in, and speak at creditors' meetings.

Based on the clarifications of the Supreme Arbitrazh Court, secured creditors still have voting rights with respect to voluntary arrangements (where unanimous vote of all secured creditors is required) at the liquidation stage (where generally secured creditors do not have voting rights) and arguably at the earlier stages of insolvency in cases when the secured creditors generally do not have voting rights (i.e. when their right to enforce security was not rejected or they have not refused to enforce).

Priority of claims

Claims of unsecured creditors

At the liquidation stage (where all creditors' claims are subject to satisfaction), the satisfaction of unsecured monetary claims against the insolvent company is generally subject to the following statutory order of priorities:

- *first*, personal injury claims and claims for moral damages (mental suffering);
- *second*, employment claims (wages and severance payments) and royalty claims under copyright agreements; and
- *third*, all other claims including claims of secured creditors to the extent their claims are not discharged out of the proceeds of sale of secured assets or the value at which the secured assets were appropriated by the secured creditor.

Settlement of claims in the above order of priority is conducted in accordance with the register of creditors' claims.

Claims submitted after the closing of the register of creditors are satisfied only after the discharge of all registered claims.

Current claims

So-called current claims (essentially, monetary claims that have arisen **after** the opening of insolvency proceedings, including court and bankruptcy costs, taxes, payments due to state budget and utilities and operational costs) together with the costs of any measures to prevent industrial or environmental harm, rank ahead of both the statutory order of priorities and claims of all creditors which have arisen **before** the date of acceptance of a petition for the debtor's bankruptcy, and are settled in accordance with the statutory order of priority specifically established for current claims. Within the same order of priority for current claims the claims are discharged in the calendar order of their occurrence.

Claims of secured creditors

The Insolvency Law expressly recognises only a pledge or mortgage as giving the holder the status of a secured creditor and it is therefore unclear what status, if any, would be afforded by other forms of security.

Claims secured by a pledge or mortgage over the company's assets are settled out of the proceeds of sale of such assets in priority to all other claims, subject to a requirement to allocate part of the proceeds to discharge claims with statutory priority of the first and second orders, and certain current claims.

According to the amended Insolvency Law the following rules on allocation of proceeds of sale of secured property at the liquidation stage currently apply:

- 80% (under a credit agreement) or 70% (in all other cases) of the proceeds (in an amount not exceeding the aggregate amount of principal and interest included in the register of creditors' claims) is applied to discharge claims of the secured creditor; and
- the remaining 20% or 30% respectively is to be deposited in a "special account" to be further applied as follows:
  - up to 15% or 20% respectively - for the satisfaction of unsecured claims with statutory priority of the first and second orders, if the unencumbered property of the debtor is insufficient to settle these claims; and
  - the balance - for the satisfaction of court and bankruptcy costs (including costs and fees incurred in connection with the sale of the secured property), payments of fees of the court-appointed administrator and persons retained by such court-appointed administrator for the purposes of administration and any remaining balance, for the satisfaction of other current claims.

If following the failure to sell the secured property at the second auction the secured creditor elects to appropriate the secured property, it must transfer 20% or 30%, as appropriate, of the value of the property at which it was appropriated, to the "special account" for the purposes of satisfaction of the above statutory prioritised claims.

To the extent unsecured claims with statutory priority of the first and second orders are satisfied, the remaining proceeds of sale of the secured property are paid to the secured creditors. If the secured claim is discharged in full, the remaining proceeds are routed to satisfaction of outstanding current claims and the balance is channelled towards discharge of creditors' claims of the third order of priority.

The Insolvency Law is unclear whether the rules on allocation of proceeds of sale of secured property described above should apply in the case of enforcement of the security by the secured creditor at the early stages of insolvency, and there is an argument that these allocation rules should apply only at the liquidation stage.

Third party security

The Insolvency Law does state that claims of creditors under pledge or mortgage agreements that are provided by a debtor as third party security (i.e. not for its own debts) are satisfied in accordance with the procedure of satisfaction of claims of secured creditors. Secured creditors under third party pledges, although not creditors having direct monetary claims against the security provider, now have the same rights as secured creditors of that security provider. However, the following restrictions and distinctions by comparison with the creditors having a direct monetary claim against the debtor apply:

- Creditors under third party pledges are not entitled to file for bankruptcy of the security provider as such secured creditor does not have a direct monetary claim against the security provider.
- Secured creditors under third party pledges may claim enforcement of the security only upon filing an application to the insolvency court asking for their claims to be included into the register of creditors as a secured creditor. The amount of their claims is to be determined on the basis of the value of the secured property provided in the pledge agreement or established by the insolvency court as the starting sale price in the course of enforcement of such security. Although not specified by law, in order to be included in the register of creditors as a secured creditor under a third party pledge, the insolvency court should most likely be provided with evidence that the claim under the secured obligation against the debtor is due and not discharged (although no court decision confirming such claim will be required to be presented to the insolvency court).

The above will not apply if the security provider gives a guarantee of the primary debt obligation and this guarantee is secured by a pledge or mortgage as in this case the secured creditor will have a direct monetary claim against the security provider under a guarantee secured by the security provider's property.

Claims of shareholders

Generally shareholders with shareholder loans are treated as other creditors. However, equity claims of shareholders may not be satisfied in insolvency proceedings and may be satisfied only upon liquidation of a company if any assets remain after all the creditors have been paid in full.

Prior Transactions

In addition to certain transactions that are prohibited or restricted at each stage of insolvency and which if entered into in violation of such restrictions may be challenged by an insolvency administrator, there are specific transactions that may be challenged in insolvency if entered into during suspect periods prior to the opening of insolvency proceedings.

Generally, the following two specific types of transaction can be challenged by an insolvency administrator in the insolvency court at the stage of external administration or liquidation:

(i) so called "suspicious" transactions which include transactions "at an undervalue" and transactions "aimed at defrauding creditors"; and

(ii) preferential transactions.

Transactions "at an undervalue" are transactions where the consideration received or to be received by a debtor is "inadequate" (if, for example, the market value of the transferred assets is significantly higher than the consideration received or to be received, taking into account the circumstances of the transaction, including where the price or other terms of such transaction are materially less favourable than those of comparable transactions concluded in comparable circumstances).

Suspect period: Transactions "at an undervalue" may be challenged if entered into or performed within **1 year** preceding, or at any time after, the opening of insolvency proceedings.

Transactions aimed at defrauding creditors are treated as such if simultaneously the following conditions are to be met:

(i) the purpose of the transaction was to prejudice the rights of creditors (such purpose is presumed, among other things, if at the time of entry into the transaction the debtor was unable to pay its debts or the liabilities of a debtor exceeded the value of its assets and (a) no consideration was paid to the debtor; or (b) the transaction was with an "interested party"[5]);

(ii) such transaction resulted in infliction of "harm to creditors' rights" (i.e. such transaction or action resulted in (a) a decrease of the value or the size of the debtor's assets; (b) an increase of the value of claims against the debtor or (c) other consequences that entail or could entail the inability of creditors to satisfy their claims (whether in full or part) from the debtor's assets); and

(iii) the counterparty knew or should have known of the above purpose of the transaction at the time of entry into such transaction (an "interested party" is presumed to know of such purpose).

Suspect period: Transactions aimed at defrauding creditors may be challenged if entered into or performed within **3 years** preceding, or at any time after, the opening of insolvency proceedings.

Preferential transactions are transactions that result or may result in preferential satisfaction of a claim of a particular creditor over other creditors, including but not limited to one of the following transactions:

(i) granting of security or guarantees for pre-existing indebtedness;

(ii) transactions that may alter the ranking of creditors' claims which arose before the entry into of such transaction;

(iii) transactions that will or may result in the satisfaction of unmatured claims of creditors where the debtor has failed to satisfy its matured claims; or

(iv) transactions which provide or may provide more priority in satisfaction of a creditor's claims which arose before the entry into of such transaction when compared to the priority to be given to such claims if their settlement was exercised according to the statutory ranking of creditors in insolvency.

Suspect period: Preferential transactions may be challenged if entered into or performed within **1 month** preceding, or at any time after, the opening of insolvency proceedings. However, preferential transactions falling within both (i) and (ii) above, or falling within any of the above where the counterparty knew of the debtor's inability to pay or that the debtor's liabilities exceeded the value of its assets, are subject to a **6 month** suspect period. A counterparty that is an "interested party" is presumed (unless proved otherwise) to have such knowledge.

Any payments made by the debtor or any actions of other persons for the account of the debtor (such as set-off (including as a result of enforcement of the existing security), debiting the debtor's account without consent of a debtor, transfer of a debtor's property, etc.) in or towards discharge of the debtor's obligations (whether scheduled or under voluntary or mandatory prepayment according to the terms of the relevant agreements or, with respect to the transfer of property, in performance of an earlier effected prepayment) within **1 month** prior to the commencement of insolvency proceedings may be challenged on the grounds of preferential satisfaction of claims of a particular creditor over other creditors. Such payments, property transfers and other actions are vulnerable irrespective of whether the recovering creditors knew or did not know of the debtor's inability to pay or insufficiency of the debtor's assets to satisfy its payment obligations at the moment of such payment or action.

As the Insolvency Law also expressly provides that security granted after the date on which the debt obligations arose may be challenged, any security granted to support debt rescheduling or mark-to-market payments made by a borrower are potentially vulnerable. It is also clear that novation agreements and settlement

[5] Interested parties include, among others, the CEO of the debtor and its directors as well as affiliates and companies comprising the so-called "group of entities" to which the debtor is attributable.

agreements (*dogovor ob otstupnom*) are now susceptible to challenge as preferential transactions.

In addition, for the **3 month** period after commencement of external administration, an external administrator may disclaim executory contracts (i.e. contracts where the other party's obligations are contingent on the company first performing its own obligation) if performance of the company's obligations under such contracts will impede restoration of its solvency or will result in losses in comparison with similar transactions entered into in comparable circumstances. The aggrieved party is entitled to claim damages caused by the company's refusal to perform. Similar rights are given to a liquidator and similar rules apply at the liquidation stage.

Vulnerable restructurings

The provisions of the Insolvency Law on preferential transactions give rise to a risk of challenging the restructuring of the financing of a Russian debtor, irrespective of whether there was an actual flow of funds (i.e. a deemed repayment of the existing loan by the debtor and provision of a new financing by the same creditor on new terms reflected by a book entry could also be vulnerable). As a result, any payments to the creditor under an existing facility effected within the suspect period (even if money was not actually transferred and irrespective of whether the refinanced facility agreement was entered into before the suspect period) may potentially be subject to a clawback to the debtor, while new money provided under a new facility and money clawed back under a refinanced facility would be subject to repayment according to a statutory order of priority in the course of the debtor's bankruptcy. Accordingly, if refinancing is made within the suspect period, the creditor may be exposed to a double risk on the debtor against which bankruptcy proceedings are initiated (i.e. for the amount of the repaid facility to be returned by the creditor to the debtor and the amount of new monies extended to the debtor).

What cannot be challenged?

The Insolvency Law specifies certain transactions that cannot be challenged in insolvency. These are:

(i) transactions concluded at an organised auction which cannot be challenged on any of the above grounds;

(ii) transactions entered into in the ordinary course of business if the value of assets disposed of or obligations incurred does not exceed 1 per cent. of the balance sheet value of the debtor's assets, which cannot be challenged as transactions "at an undervalue" or as "preferential transactions"; and

(iii) transactions where the debtor received adequate consideration unless such transactions are treated as "aimed at defrauding creditors".

Who can challenge?

A claim for the invalidation of a transaction in insolvency can be brought to the insolvency court by the liquidator or external administrator of a debtor either at his own discretion or when instructed by a creditors' meeting or committee (thus limiting the ability of individual creditors to challenge transactions).

What are the consequences of successful challenge?

Everything received under a successfully challenged transaction will be subject to clawback (and all assets disposed of by the debtor under such transactions are to be returned to the bankrupt estate).

Liability of the management and shareholders

Liability of "controlling persons"[6] (including directors) and its shareholders in the case of the company's insolvency are regulated by a number of Russian laws. Depending on the type of action and its gravity, a director may be subject to civil, administrative or criminal liability.

Civil liability

If bankruptcy of a company is caused by the shareholders (participants) or other persons who have the right to give binding instructions to such company or otherwise are able to determine the actions of the company, such persons can bear subsidiary liability for the company's obligations if the assets of the company are insufficient to discharge the debtor's obligations. Apart from limited liability companies in relation to which the liability of "controlling persons" is not restricted by any subjective test, the scope of the potential liability of "controlling persons" with respect to joint stock companies is restricted to situations where such "controlling persons" have used their right to give binding instructions to, or used their ability to determine the actions of the company with the purpose of the company taking an action knowing in advance that such action would entail the company's insolvency.

Liability of "controlling persons" for the insolvent company's debts

In addition to the general liability envisaged by civil legislation, the Insolvency Law sets out the specific

[6] For the purposes of the insolvency legislation a controlling person means a person who, within the two year period prior to the commencement of insolvency proceedings, has or had the right to give binding instructions to the debtor or otherwise is or was able to determine the debtor's actions. The Insolvency Law expressly provides that "controlling persons" include (i) members of the debtor's liquidation commission; (ii) the debtor's authorised representatives (whether authorised by virtue of a power of attorney, regulation or special authorisation); and (iii) persons (entities) that had the right "to dispose of 50 per cent. or more" of the voting shares (in the case of a joint stock company) or more than 50 per cent. of participatory interest (in the case of a limited liability company).

grounds and the level of liability of the company's management, shareholders and other "controlling persons" for the company's debts.

The shareholder and management as well as other "controlling persons" of a Russian debtor that was declared bankrupt could jointly and severally bear secondary liability for monetary claims of creditors (including current claims) against, and mandatory payments due from, such debtor, when simultaneously:

- the insolvent debtor has acted on instructions from its "controlling persons";
- such actions resulted in a "harm to creditors' rights"; and
- the bankruptcy estate is insufficient to satisfy the creditors' claims, mandatory payments and current claims.

Russian courts may, at their discretion, reduce the liability of a "controlling person" if the loss caused by the debtor acting on the controlling person's instructions was disproportionately lower than the amount claimed by creditors. Furthermore, "controlling persons" are exempt from liability if they can prove that they acted in good faith and reasonably in the interests of the debtor.

In a situation where the accounting or reporting documentation of the debtor that is required to be produced by Russian law appears to be missing, or the relevant information on the assets and liabilities of the debtor and their movement appears to be incomplete or untrue, in each case as of the date of instigation of the supervision stage or declaration of the debtor's bankruptcy, the chief executive officer (the "**CEO**") of the debtor also bears secondary liability for the obligations of the debtor.

In addition to the above, the persons (generally the CEO and a liquidator, as appropriate) who failed to file for the company's bankruptcy when were obliged to do so by law (see "*Petition by the company*" above), may bear secondary liability for new debts of the company arising after the date when the bankruptcy petition should have been filed.

Criminal liability

A court may find the CEO of a company or its founders (participants) criminally liable to a fine or imprisonment up to 6 years in cases provided in this section.

The Criminal Code imposes criminal liability for actions taken in anticipation of bankruptcy as well as for the actions taken during insolvency of a company.

In particular, the Criminal Code imposes criminal liability for the following:

(a) deliberate bankruptcy when the CEO or a founder (participant) of the company takes or omits to take actions which he knows will result in the company's inability to satisfy in full its creditors' claims;

(b) fraudulent bankruptcy when the CEO or a founder (participant) of the company knowingly makes a fraudulent public announcement of bankruptcy of that company;

(c) unlawful actions during bankruptcy proceedings that, among other things, contemplate:

  (i) concealing property, rights to property or liabilities, withholding information on property, its size, location or any other information on property, rights to property or liabilities, transferring property to others, alienating or destroying property and concealing, destroying or falsifying accounting documents, in each case if such actions have been taken when there were signs of bankruptcy of the company and caused substantial damage;

  (ii) unlawful satisfaction by the CEO or a founder (participant) of claims of certain creditors out of the company's assets made with the intention of defrauding other creditors, if such actions have been taken when there were signs of bankruptcy of the company and caused substantial damage;

  (iii) unlawful actions aimed at impeding the activity of a court-appointed administrator, including evading transfer of the documents necessary for performance of its duties or the debtor's property or refusal to do so, where the management power of the debtor's CEO is vested in a court-appointed administrator, if such actions (or omission to act) caused substantial damage.

Administrative liability

The Administrative Offences Code also imposes liability on the CEO of a company, its founders (participants) or a court-appointed administrator (where appropriate) with respect to bankruptcy. This includes the following administrative offences:

(a) fraudulent bankruptcy;

(b) deliberate bankruptcy;

(c) unlawful actions during bankruptcy, already mentioned in paragraph (c) of the *Criminal liability* section;

(d) acceptance by a creditor of the unlawful satisfaction of its claims out of the debtor's assets knowing of the prejudice of other creditors, if such action was taken when there were signs of the company's bankruptcy;

(e) failure by a court-appointed administrator to perform its obligations under the Insolvency Law; and

(f) failure by the company's CEO to file a bankruptcy petition against a company in the cases provided for in the Insolvency Law.

The offences referred to in paragraphs (a) to (e) will be subject to administrative liability to the extent such offences are not subject to criminal liability (i.e. when the consequences of an offence are less serious than in the case of criminal liability).

The Administrative Offences Code envisages administrative fines of up to RUR 50,000 or disqualification for a period from 6 months up to 3 years as the main sanction on directors.

Disqualification entails depriving an individual of the right to occupy any management position in the executive body of a legal entity, to sit on the board of directors, management (supervisory) board and to carry out entrepreneurial activity involving management of a legal entity.

Are there any expected amendments to the insolvency legislation?

Despite recent significant amendments to the Insolvency Law regarding the status of secured creditors, which introduced new criteria for challenging transactions in a debtor's insolvency and strengthening liability of debtor's controlling persons, the Insolvency Law continues to develop. At the moment there are proposals from the Russian government on further amendments to the law which, among other things, envisage the following:

- introducing rules on crossborder insolvency aiming (a) to determine cases when the Russian courts have jurisdiction to hear crossborder insolvency proceedings, (b) to identify the law to be applied in the event of crossborder insolvency proceedings, (c) to establish the rules on recognition and enforcement of foreign court judgements on insolvency cases; and (d) to address issues arising in the event of initiation of conflicting insolvency proceedings against the same debtor in different jurisdictions;
- introducing new rules for financial rehabilitation with the purpose of expanding the role and use of such procedure for restoring a debtor's solvency as well as establishing rules on out-of-court settlement of creditors' claims by imposing the institution of standstill agreements.

At the moment the above amendments have not been presented to the State Duma and are still in the process of discussion and further development.

Insolvency and Restructuring Trends in Europe: Automatic Stay and Rescue Procedures

England & Wales	France	Germany	Italy	Spain	The Netherlands	Hungary	Russia
Yes, in administration. Exceptions for secured creditors (who may enforce security with leave or consent).	*Mandat ad hoc* and conciliation procedures do not feature an automatic stay, but deferral of payment may be granted for up to 2 years in respect of individual creditors. Safeguard, rehabilitation and liquidation proceedings feature an automatic stay in respect of payment of debts originating prior to the commencement of the proceedings and commencement of legal actions.	During preliminary proceedings, a provisional stay of execution may be ordered by the insolvency court. After the opening of insolvency proceedings with the exception of claims assigned for security purposes and assets in the possession of the administrator, enforcement of security is possible – unless prohibited by court order (if the assets are required to continue the debtor's business in such cases interest and compensation for loss in value is to be paid to the secured creditor).	Yes. In "*Concordato Preventivo*" (Composition with Creditors) and "*Accordo di Ristrutturazione*" (Restructuring Agreement), 2 yrs maximum. Security (other than pledges, which can be enforced according to their terms) cannot be enforced.	Enforcement of security suffers delay up to 1 year.	Initially for 2 months. May be extended for further 2 months, secured creditors may enforce unless enforcement prohibited by court order.	In liquidation proceedings the court may grant a 30 day standstill period upon the request of the debtor company before the commencement date of the liquidation (being the date when the final and non-appealable order of the court on the commencement of the liquidation proceedings is published in the Company Gazette). However, if the bankruptcy procedure has taken place before the initiation of the liquidation proceedings, and in the bankruptcy procedure the debtor company was given a more than 30-day standstill period, no standstill period is applicable in liquidation. Upon filing a petition for bankruptcy proceedings at court by the managing directors of the debtor company, a temporary moratorium is granted automatically to the company by the court. The length of the moratorium is 90 to 365 days.	Generally speaking once insolvency proceedings are commenced, creditors' claims are dealt within the insolvency process and are to be included in the company's register of creditors' claims to ensure that the registered creditors have a say in insolvency process and priority in satisfaction of their claims over non-registered claims. Any monetary claims or steps to enforce against the assets of the company are suspended (save for a limited number of exceptions, prescribed by law). Enforcement of pledges and mortgages is also prohibited. Pledged (or mortgaged) assets are segregated from the other assets and cannot be sold without the consent of the secured creditor. At the financial rehabilitation and external administration stages security may be enforced subject to certain company's recovery driven limitations, but only by way of a court driven sales process conducted at a public auction.

Insolvency and Restructuring Trends in Europe: Automatic Stay and Rescue Procedures (continued)

Luxembourg	Belgium	Poland	The Czech Republic	Slovakia	Romania	Ukraine
Yes, during the controlled management procedure until a final decision is taken by the court.	Yes, during judicial reorganisation proceedings, enforcement action is generally suspended for a period of 6 months for a temporary moratorium (which can be extended to 18 months). A definitive moratorium can last up to 5 years in the event of a collective reorganisation provided that there are certain limitations on the suspension of claims for payment of secured creditors. In particular, interest must be paid on the claims of such creditors, and their claims for repayment cannot be suspended for more than 36 months.	Yes, for up to 3 months. Bankruptcy with a composition option and recovery proceedings do not affect the rights of secured creditors who can enforce their claims.	Yes, stay kicks in upon the filing of the insolvency petition, applies to both unsecured and secured creditors. In reorganisation, the stay is not limited in time, but, save for very large debtors commencement of reorganisation is subject to creditor approval. Also secured creditors are protected by interest payments on the value of their security.	Yes, during restructuring including the enforcement of security.	Yes, during judicial reorganisation, a secured creditor can request that the stay be cancelled if the assets are not crucial to the success of the plan.	Yes, moratorium on claims and default interest until the end of the insolvency proceedings. The restated Enforcement Law has recently (March 2011) confirmed the possibility of enforcement of a security during insolvency.

Insolvency and Restructuring Trends in Europe: Cram Down of Creditors

England & Wales	France	Germany	Italy	Spain	The Netherlands	Hungary	Russia
Yes, schemes under Part 26 of Companies Act 2006 require majority in number of creditors, three quarters in value of claims. Yes, for Company Voluntary Arrangements the proposal for restructuring needs to be approved by more than half in value of the shareholders and more than three quarters in value of the creditors.	Yes, as regards members of creditors' committees and bondholders, subject to majority votes by creditors' committees representing not less than two thirds of the debt, and to the required majorities in bondholders' assemblies.	Insolvency plan must be approved by majority of creditors in each class who must hold more than half of the claims in value in each class. Court can override if non-concurring group would be worse off without the plan.	Yes, composition with creditors must be approved by majority of classes of voting creditors.	Yes, an arrangement may be entered into with creditors based upon a vote by the majority of creditors.	Yes, a composition needs the approval of a normal majority of creditors representing at least half of the total amount of claims.	"Cram down" of creditors is possible. If a composition agreement was concluded either in liquidation or bankruptcy (reorganisation) proceedings, with the consent of the required proportion of creditors, the composition agreement has to also apply to non-consenting creditors.	A voluntary arrangement if sanctioned by the court, after it has been approved by a majority of registered creditors and received the unanimous consent of any registered secured creditors, will bind the company and its registered creditors irrespective of whether they voted against it or not voted at all. A debt repayment schedule in financial rehabilitation and a plan for restoring solvency in external administration are approved by a majority of the total number of registered creditors by claims and then must be approved by the court.
Luxembourg	**Belgium**	**Poland**	**The Czech Republic**	**Slovakia**	**Romania**	**Ukraine**	
Yes, controlled management requires adherence of a majority of creditors in number and more than half in value to the restructuring plan or the draft plan relating to the realisation and distribution of assets. Pre insolvency composition arrangements require consent of a majority in number of creditors and three quarters in value.	A recovery plan must be approved by more than half in number and value of all the creditors. It must also be approved by the court. Once approved, a plan binds dissenting creditors, even secured creditors.	A composition plan must be accepted by a majority of each group of creditors whose claims amount to two thirds in value of those entitled to vote. The judge-commissioner can in the event of each group not voting in favour, approve the plan if the majority of groups approve it and any dissenting groups are no worse off than in a liquidation.	Yes, in a reorganisation a majority in number and by amount of claims in each class is needed to approve. The Court may also confirm the reorganisation plan subject to specific criteria being met.	Yes, in a restructuring a majority by number and by amount of claims in each class is needed to approve a restructuring plan, the Court may also confirm the plan subject to specific criteria being met.	Yes, in a judicial reorganisation a majority by number and amount of creditors in each class is needed to approve a reorganisation. This is also subject to the approval of the Court.	"Cram down" of creditors is possible. Creditors must approve the rehabilitation plan by a simple majority and then it must be approved by the Court. However secured creditors' claims may not be forgiven or written off without the consent of each relevant secured creditor.	

Insolvency and Restructuring Trends in Europe: Position of Management

England & Wales	France	Germany	Italy	Spain	The Netherlands	Hungary	Russia
Effectively displaced, unless otherwise agreed by Administrator. Administrator selected by the company or secured creditor.	*Mandat ad hoc* and conciliation procedures: management stays in possession, assisted by a court-appointed officer in order to facilitate the restructuring of the liabilities. Safeguard Proceedings: management stays in possession. Rehabilitation Proceedings: appointment of a judicial administrator, who either assists or replaces management. Judicial Liquidation: the liquidator replaces the management.	Usually management: (1) continues to manage business during the preliminary proceedings subject to the consent of the preliminary administrator; (2) is displaced by court appointed receiver after the opening of insolvency proceedings. However the court may: (1) during preliminary proceedings order the transfer of management to the preliminary administrator; (2) upon the debtor's request, order the opening of debtor-in-possession like proceedings with the management continuing to manage the business under supervision of a specific creditors' trustee.	Effectively displaced by court appointed receiver, although in the context of concordato the management still remain in place but are subject to the control of the judicial commissioner.	In cases of voluntary insolvency, the receivers supervise the directors' decisions. In case of compulsory insolvency, the management is effectively displaced by receivers.	Effectively displaced by court appointed administrator.	In case of liquidation proceedings, the management are effectively displaced by court appointed liquidator. In the course of a bankruptcy procedure, the management retain their powers, however receive assistance from the court appointed administrator.	During the supervision stage, the company's management stays in place (although with limited authorities) and an interim administrator is appointed by the court following its nomination by a petitioner filing for the company's bankruptcy (i.e. the company itself or its creditor). For financial rehabilitation an administrator is chosen by the creditors' committee and then approved by the court but management again remains in place (although with limited authorities). If the company is subject to external administration or liquidation then the management is replaced by an administrator proposed by the creditors' committee and approved by the court.

Insolvency and Restructuring Trends in Europe: Position of Management (continued)

Luxembourg	Belgium	Poland	The Czech Republic	Slovakia	Romania	Ukraine
During the first phase of controlled management, the directors remain in place, but actions are supervised by magistrate appointed by the court. In the second phase a "*commissaire*" is appointed that supervises management in accordance with the mandate of the court. In bankruptcy proceedings a "*curateur*" displaces management.	Management retain their powers during the observation period of judicial reorganisation. The court however, retains the power to remove the management and to appoint a provisional manager in cases of fraud and gross incompetence.	In bankruptcy proceedings the management is effectively displaced by a court appointed bankruptcy officer (save for bankruptcy carried out for composition, where "debtor in possession" is optional). In recovery proceedings the management remains (subject to certain controlling powers of the court-appointed supervisor).	In a reorganisation, the debtor's management remains in control, but is monitored by a court appointed trustee and creditors' committee.	In a restructuring, the debtor's management remains in control, but is monitored by a trustee and the court.	In a judicial reorganisation, the debtor's management remains in control under the supervision of the judicial administrator.	Management normally remains in place during property administration stage but may be replaced by court upon request of the creditors' committee. In any event, its actions will be supervised by the property administration manager. On rehabilitation the rehabilitation manager replaces management. During liquidation the management is dismissed and the liquidator takes over the management of the debtor.

Insolvency and Restructuring Trends in Europe: Personal Liability of Directors

England & Wales	France	Germany	Italy	Spain	The Netherlands	Hungary	Russia
Yes, for breaches of duties, wrongful trading and fraudulent trading (ss212-214 IA 1986).	Yes, in case of faults of management having contributed to the insufficiency of assets or the company's insolvency; also in case of fraud, etc.	Yes, for failure to file for insolvency, for any payments made to third parties after the company becomes insolvent and for any new agreements which the company is unable to fulfil.	Yes, for breaches of duty and failure to preserve the company's value if that failure results in a loss to creditors. Criminal liability of directors in case of ■ distracted, disguised or voluntarily lost the assets; ■ taken imprudent actions to delay the declaration of bankruptcy; ■ disguised its financial distress or its insolvency state in order to obtain financing.	When insolvency has been considered as negligent, and provided that they have contributed to provoke the insolvency.	Yes, for mismanagement, fraud or if they have contributed to company's insolvency.	Directors are liable for breach of statutory and contractual duties, breach of the company's deed of foundation and any of the members' / shareholders' resolutions in accordance with the relevant rules of the Hungarian civil law. Liability of former directors and shadow directors is established by the Bankruptcy Act in case they failed to properly prioritise the rights of creditors. Criminal law sanctions exist for certain acts, e.g. violation of accounting regulation, bankruptcy crime, concealment of assets, etc.	Depending on the type of action and the gravity of the situation a director and a shareholder (or any other controlling person) may be subject to civil, administrative or criminal liability. For civil liability claims financial compensation of creditors' losses caused by the company acting on the controlling person's instructions may be sought in the lack of bankruptcy estate sufficient to discharge creditors' claims in full, unless the controlling persons can show that they acted in good faith and reasonably, and in the interests of the company. Bespoke criminal offences and administrative offences also attract liabilities to pay fines or impose criminal sanctions.
Luxembourg	**Belgium**	**Poland**	**The Czech Republic**	**Slovakia**	**Romania**	**Ukraine**	
Yes, for any wrongdoing or negligence under general corporate law. Criminal liability in respect of certain actions which have lead to the insolvency (including lack of declaration, wrongful or fraudulent trading) other sanctions include extension of liability for some or all debts incurred.	Yes, if grossly negligent in a way that contributes to the bankruptcy.	Yes, for breaches of fiduciary duties, contractual duties or statutory duties. Wrongful or fraudulent trading triggers civil liabilities and may in certain circumstances lead to criminal liability. Directors are criminally liable for preferential treatment of creditors.	Yes, for breaches of fiduciary duties owed to creditors while in office after commencement and for damages caused to creditors by delay in filing an insolvency petition.	Yes, for breaches of fiduciary duties, diminishing value of assets and circumventing the success of the restructuring process.	Yes, for breaches of fiduciary and statutory duties and where directors have contributed to the debtor's insolvency. Criminal sanctions exist for certain acts.	Yes criminal liability for fraudulent, deliberate bankruptcy, concealing insolvency and illegal actions before or during bankruptcy. There is no well established practice, however, of attaching liability to a director for a failure to commence insolvency.	

Insolvency and Restructuring Trends in Europe: Time Limits for Filing

England & Wales	France	Germany	Italy	Spain	The Netherlands	Hungary	Russia
No express time limit for filing for insolvency but failure to do so which results in a loss may give rise to action against directors personally.	Obligation to file within 45 days of the company being unable to pay its debt as they fall due.	Obligation to file immediately upon company being unable to pay its debts currently due or over indebtedness occurring; filing may be postponed for up to 21 days if reasonable expectations exist that insolvency can be overcome.	No express time limit for filing for insolvency but failure to do so which results in a loss may give rise to action against directors personally.	Obligation to file within 2 months of when the debtor has or should have become aware of its insolvency. Failure to comply assumes that bankruptcy is carried out negligently.	No express time limit for filing for insolvency but failure to do so which results in a loss may give rise to action against directors personally.	No express time limit for filing. In bankruptcy procedure, the company has to notify the court of the result of the creditors' meeting within 5 business days.	A third party creditor may petition for the bankruptcy if the unpaid debt is not less than RUR 100,000 (approximately USD 3.550), is overdue by at least three months and is confirmed by the court decision entered into force. The chief executive officer of the company must petition for the bankruptcy within 1 month of it meeting the insolvency tests (i.e (i) is unable to perform its payment obligations in full; or (ii) is subject to enforcement proceedings that make it impossible for the operations to continue; or (iii) the company ceases to pay its matured debts on account of insufficient funds or has insufficient assets to pay its monetary liabilities.)
Luxembourg	**Belgium**	**Poland**	**The Czech Republic**	**Slovakia**	**Romania**	**Ukraine**	
Obligation to file within 1 month of company having stopped making payments.	Directors must file within 1 month of it being unable to pay its debts.	Obligation to file within 2 weeks of insolvency (unable to pay debts as they fall due or debts exceed assets).	No express time limit but must file without delay after they have determined the company is insolvent, insolvency is defined objectively including express time periods of default with payment.	Obligation to file within 30 days after the directors have determined that the company is insolvent.	Obligation to file within 30 days from the date that it is aware that it is or will become insolvent.	Within one month of being unable to satisfy claims.	

Insolvency and Restructuring Trends in Europe: New Reforms

England & Wales	France	Germany	Italy	Spain	The Netherlands	Hungary	Russia
Banking Act 2009 introduced special administration and insolvency procedure for banks and investment banks. Draft proposals to introduce more stringent disclosure on pre-packs and also the possibility of introducing a general restructuring moratorium is being considered.	New law came into force in January 2006. Further reforms on 15 February 2009. New Accelerated Safeguard Proceeding introduced 1 March 2011.	Recent reforms introduced on 1 November 2008 by the Act of modernisation of the Limited Liability Company Law and the Prevention of Abuse. Insolvency law reform expected in the course of 2011 concerning insolvency plan proceedings, facilitation of self-administration and strengthening creditor rights.	Significant reforms 2003-2010. Stability measures introduced by Legislative Decree No. 78/2010 in the context of rescue procedures including priority for rescue or interim finance and a disapplication of the rules on equitable subordination.	A reform of the Insolvency Law is currently under discussion, with proposals likely to be in force sometime in early 2012.	Substantial revisions proposed in 2007 but Minister of Justice concluded in 2011 that there was no requirement for legislation at present.	Extensive revision of the Bankruptcy Act came into effect on 1 September 2009. The main purpose of the amendment is to simplify and make more effective the bankruptcy procedure.	The Insolvency Law was amended significantly at the end of 2008 and in the middle of 2009. There are further proposals which are the subject of discussion; these relate to cross border insolvencies and the introduction of new rules for expanding the recovery role of the financial rehabilitation procedure.

Luxembourg	Belgium	Poland	The Czech Republic	Slovakia	Romania	Ukraine
No substantial revisions proposed.	Recent reforms for rescuing financial institutions have been introduced.	Reforms: Bankruptcy and Recovery Law 2003. Recent reforms: 31 March 2009.	Recent Reforms: Insolvency Act No 182/2006 Coll. Effective since 1 January 2008. In July 2009 substantive amendments aimed at easing the effect of the downturn. In March 2011 further amendments regulating the claim process.	Recent Reforms: Bankruptcy and Restructuring Act No 7/2005 Coll. Effective since 1 January 2006.	Recent Reforms: Insolvency Law No 85/2006 and Law No 381 2009 introduced a judicial moratorium and ad hoc mandate for out of court restructuring.	No recent substantial revisions. However, a completely new law was drafted by the working group of judges, insolvency practitioners and experts including Clifford Chance Ukraine and is being considered by a wider group of experts and practitioners.

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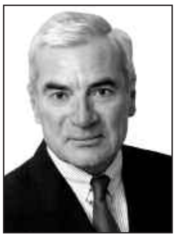

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