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© 2019 Law Business Research Ltd
I am very pleased to present this twelfth edition of *The Restructuring Review*. As with the previous editions, our intention is to help general counsel, private practice lawyers and the public sector understand the conditions prevailing in the global restructuring market in 2019, and to highlight some of the more significant legal and commercial developments and trends that have been evident in recent years, and that are expected to be significant in the future.

In what appears to be a growing trend, the global economic situation, particularly for European and other Western countries, continues to be uncertain. Despite the modest strengthening of global GDP in recent years, unresolved trade tensions between the United States and China continue to unsettle markets and European countries remain in the grip of an ongoing impasse over Brexit.

According to figures published by the International Monetary Fund (IMF), global GDP growth is expected to fall from 3.6 per cent in 2018 to 3.3 per cent in 2019, with growth in the European Union falling from 2.1 per cent to 1.6 per cent over the same period. Political instability in the European Union shows no signs of abating, and remains highly visible in movements such as the ‘gilet jaunes’ in France or success of populist political parties in the European Parliament elections held in May 2019. The extent of national public debt and non-performing loans in the eurozone also continue to present a major challenge to eurozone economies and the legacy of the 2008 crash is still readily apparent in countries such as Italy and Greece. Although the European Central Bank (ECB) made good on its promise to end quantitative easing by the end of 2018, interest rates in the eurozone remain at record lows and the impending departure of Mario Draghi as ECB president leaves something of a question mark over the future trajectory of European monetary policy.

More broadly, the tensions surrounding the Middle East and Russia show no indication of being resolved, and differences in global attitudes to climate change are beginning to reveal a new, and potentially very significant, source of contention between the world’s major powers.

With the ever-increasing significance of the Chinese and other Asian economies on the world stage, it is also notable that the seemingly endless trend of high-paced growth appears to be slowing, with IMF figures predicting a fall in Chinese growth from 6.6 per cent in 2018 to 6.3 per cent in 2019, and a continued decline in subsequent years. Effects are bound to be felt on the global stage as the world adapts to the slowdown.

While, of course, unforeseen circumstances have a tendency to derail even the most cautious of predictions, uncertainty and financial stress are usually good indicators that a turn in the economic cycle is approaching. As such, the twelfth edition of this work continues to be relevant and important, in particular, as a result of the increasingly cross-border nature of many corporate restructurings.
As ever, I would like to extend my gratitude to the contributors from some of the world’s leading law firms who have given such valuable support and cooperation in the preparation of this work, and to our publishers, without whom this work would not have been possible.

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Retired partner of Skadden, Arps, Slate, Meagher & Flom (UK) LLP
London
July 2019
Chapter 1

ARGENTINA

*Fernando Daniel Hernández*

I

OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

During the past decades, Argentina has repeatedly gone through financial and economic crises, both resulting from the international context and the policies implemented by its own administrations, which until now have consistently avoided adopting the required deep structural changes necessary to secure sustainable growth.

The last liquidity crisis in Argentina was caused by the repeal of the Convertibility Law in 2001, which pegged the Argentine peso to the United States dollar at a parity of 1:1.

After the 2000s’ crisis, the Kirchner administrations ruled Argentina for more than 12 years. By the end of 2015, Argentina was again facing a foreign exchange and foreign reserves crisis (which was contained through an increasing set of foreign exchange restrictions), increasing inflation, loss of competitiveness, recession and fiscal deficit. In December 2015, however, a new administration led by President Macri took office. In a very short time the new administration settled the claims from the holders of the sovereign debt, which was in default since 2001; lifted all foreign exchange restrictions; and commenced the adoption of some of the required structural measures, addressing some of the mayor problems in the economy.

By the end of 2018, however, Argentina faced a new foreign exchange crisis again, driven, mostly by foreign factors like the increase of the US Federal Reserve’s interest rates, the increasing political and economic crisis in Brazil and other local factors. The latter included the change of the administration’s inflation expectations for 2018, an increasing issuance of LEBACs (peso-denominated debt securities of the Argentine Central Bank), the passing of a law by the opposition in Congress restricting the ability of the administration to increase public tariffs (which has been vetoed by the President), a historical drought that affected crop production and the failure of the administration to continue implementing the required structural changes necessary to reduce the fiscal deficit and inflation. As a consequence, during 2018 the Argentine peso depreciated by 103.83 per cent against the US dollar and inflation soared to 47.6 per cent.

In response to the new foreign exchange crisis, the federal government and the Argentine Central Bank adopted a series of measures. On 7 June 2018, the federal government and the International Monetary Fund entered into a technical agreement to grant a stand-by loan of up to US$50 billion for a term of up to three years to strengthen the federal reserves and Argentina’s financial and fiscal position, which was later increased by an additional US$7.1 billion. By April 2019, the International Monetary Fund had disbursed an aggregate

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of US$39.1 billion of the facility. In addition, the Argentine Central Bank defined foreign exchange intervention and non-intervention zones for the US dollar exchange rate and increased the amount of Leliqs (peso debt instruments of the Argentine Central Bank), which by the end of 2019 would represent around 4 per cent of the gross domestic product (GDP), with interest rates of more than 70 per cent. In an effort to reduce the volatility of the US dollar exchange rate, on 29 April 2019, the committee of monetary policy of the Argentine Central Bank announced that it could sell foreign currency even if the exchange rate is below the upper threshold and increased the daily sales from US$150 million to US$250 million if the exchange rate is beyond the upper threshold.

Those and other measures adopted by the federal government and the Argentine Central Bank to control the foreign exchange rate caused a deepening recession (the IMF projected a GDP decrease of 1.2 per cent for 2019), increasing unemployment and medium and small companies’ failures. Despite the adoption of those measures, inflation and foreign exchange instability continued. In March, inflation increased by 4.7 per cent, with an accumulated increase of 11.8 per cent during the first quarter and an inter-annual increase of 54.7 per cent; while between January and April 2019 the Argentine peso depreciated by 17.09 per cent. In addition, in October 2019 there will be presidential elections, and there is a great degree of uncertainty and speculation regarding whether Mauricio Macri will be elected or who may be his successor, which has also contributed to the economic instability. However, since May 2019, the dollar exchange rate has stabilised and inflation has begun to reduce slowly.

In the short term, those measures caused a contraction of Argentine economic activity and consumption. The increased cost of financing in pesos, the increase of the US dollar exchange rate and the sharp fall in consumption have caused an increase in the number of business failures over the last 12 months.

II  GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i  Insolvency proceedings

Insolvency proceedings are governed by the Argentine Insolvency Law No. 24,522,2 as amended, which provides for three different types of insolvency proceedings: (1) two reorganisation proceedings: acuerdo preventivo extrajudicial (out-of-court restructuring agreement, similar to pre-packaged restructurings in the United States); and concurso preventivo de acreedores (the reorganisation proceedings, similar to a Chapter 11 proceeding under the United States Bankruptcy Code); and (2) a quiebra (liquidation proceeding or bankruptcy, similar to a Chapter 7 under the United States Bankruptcy Code).

The out-of-court restructuring agreement

The out-of-court restructuring agreement is a private restructuring agreement entered into by the debtor and its unsecured creditors classified in one or more categories. The agreement is binding, unless provided otherwise. If the debtor obtains the consent to the out-of-court restructuring agreement by unsecured creditors within each category representing, more than

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50 per cent in number and more than 66.66 per cent in principal amount (the Requisite Majority), then the debtor may file the out-of-court restructuring agreement before a competent court for endorsement.

For purposes of computing the Requisite Majority, the holders of debt securities issued in series must grant their consent at a noteholders’ meeting or in such other manner as provided in the documents governing the securities, subject to the court’s satisfaction. The headcount and principal majorities at a noteholders’ meeting are computed as follows:

- All votes of the noteholders supporting the plan are computed as given by one person and all votes opposing the plan are computed as given by one person;
- The aggregate principal amount of debt securities held by the noteholders that consent to or oppose the plan are added to that of the other creditors also supporting or opposing the plan; and
- In addition, following broadly accepted case law, the principal amount of the debt securities held by the noteholders not attending the noteholders’ meeting or abstaining from voting, are not computed in the calculation of the principal majority.

Upon endorsement by the court, the out-of-court restructuring agreement is binding on all unsecured creditors of the same categories.

Filing of a petition for confirmation of an out-of-court reorganisation agreement does not have any effect on secured creditors’ enforcement rights on the collateral.

**Reorganisation proceedings**

Reorganisation proceedings is a court-sanctioned reorganisation that is controlled by the court and supervised by a receiver. The filing for a petition for the commencement of a reorganisation proceeding is only voluntary, either through a direct filing for reorganisation by the debtor, or a debtor’s motion for the conversion of a bankruptcy adjudication into a reorganisation.

Commencement of a reorganisation proceeding has, among others, the following effects:

- The court appoints a receiver, who supervises the process and the debtor’s assets and business during the proceedings; and control committee, which is integrated by the three largest unsecured creditors and a representative of the employees;
- The debtor’s financial obligations are accelerated;
- Suspension of accrual on interest on unsecured pre-petition claims;
- The automatic stay of pre-petition unsecured monetary claims;
- Pre-petition creditors (unsecured and secured) must file proof of claims; and
- The debtor keeps possession and administration of its assets in the ordinary course of business; provided that, the debtor may not incur in any gratuity, or any other act that may result in the alteration of the pre-petition creditors’ situation, and, without the prior consent of the court, may not undertake any act on registrable assets (i.e., real state and vehicles), lease or sale of goodwill, issue secured debt or perform any other act beyond the debtor’s ordinary course of business.

The debtor has an exclusivity period of 90 business days (that may be extended once for another 30 business days) within which it must formulate a reorganisation plan for each category of unsecured creditors and obtain the consent to it by the requisite majority.
Secured creditors’ enforcement rights on collateral will be subject to the filing of proof of the claim and security. Secured creditors constitute one of the mandatory categories of creditors, but any proposal to them, other than the payment in their original terms, requires the consent of all secured creditors.

Commencement of a reorganisation proceeding does not itself affect the rights and remedies of secured creditors on the collateral; provided that in the event of manifest need or urgency the court may order a temporary stay of the realisation of the collateral and a temporary suspension of any injunction enjoining the use of the collateral by the debtor, in both cases for a term not exceeding 90 business days. Any interest accrued during the term of the stay or suspension not satisfied out of the proceeds of the realisation of the collateral will enjoy the preference of administrative expenses in liquidation.

**Liquidation**

The liquidation may be voluntary or involuntary. A voluntary liquidation may be commenced by a petition filed by the debtor. An involuntary liquidation may be commenced by a petition of a creditor or by failure of a reorganisation proceeding. Upon commencement of a liquidation, the court appoints a receiver, who takes possession of the estate and seeks to liquidate the estate’s assets and distribute the proceeds among the estate’s creditors in proportion to their respective claims, according to their respective preferences.

Among other things, upon bankruptcy adjudication:

a. all the debtor’s assets (except, among others, for non-monetary rights and non-attachable assets) pass to the estate and are managed by the receiver;
b. all creditors (including unsecured and secured) must submit proof of claims before the receiver;
c. all claims become due and payable;
d. accrual of interest on unsecured claims is suspended;
e. all monetary claims against the debtor, including secured claims (except for seizure proceedings, family law claims, ordinary proceedings, labour claims and claims in which the debtor is a joinder defendant) are consolidated at the bankruptcy court; and
f. all claims denominated in foreign currency are mandatorily converted into local currency.

Bankruptcy adjudication does not suspend the accrual of interest on the secured claims; provided that interest may only be payable out of the proceeds of the collateral after deduction of the court costs, any preferred interest accrued before the bankruptcy adjudication date (as described above) and principal.

Upon bankruptcy adjudication, all foreclosure proceedings on credits secured with real property are consolidated before the bankruptcy court, and upon bankruptcy adjudication becoming final all individual foreclosure proceedings will be stayed.

Provided that proof of the claim and privilege has been duly filed, secured creditors may request the realisation of the collateral at any time at court. The court will decide whether to admit or deny the request; if admitted, this will proceed at an ancillary special liquidation proceeding.

Despite the foregoing, the receiver may request court authorisation to satisfy the secured credit in full with liquid funds available if maintenance of the collateral is beneficial for the creditors. To this effect, the court may authorise the receiver to grant other securities to the secured creditor or sell other assets.
Immediately upon bankruptcy adjudication, the receiver may decide to continue the business activities of the debtor; this decision must be confirmed by the court. If the continuation is decided, during the term of continuation enforcement of collateral needed for the business exploitation is stayed when (1) the secured credit is not due as of the bankruptcy adjudication date and the receiver performs the obligations due after such resolution in due time; (2) the secured credits are due as of the bankruptcy adjudication date but the security is not admitted by a final and non-appealable resolution; or (3) the secured creditor consented the stay of the enforcement.

In addition, in the case of continuation the court may also order the stay of collateral enforcement proceedings at the request of an employees’ cooperative (formed for the purposes of bidding for the purchase of debtor’s equity in the competitive bidding process or otherwise requesting the acquisition of debtor’s equity prior to liquidation of the estate) for a maximum term of two years.

ii Director’s duties

Under the Argentine General Companies Law No. 19,550,3 the directors of the debtor are subject to the duties of loyalty and diligence and may be subject to liability for their violation. The duty of loyalty embraces the obligation to act with the correctness of an ‘honest person’ and in defence of the interests of the debtor. The duty of diligence requires, among other things, that the director possesses certain minimum qualifications (i.e., technical knowledge and expertise).

When a debtor becomes insolvent, the directors’ duties in relation to the creditors are strengthened. The members of the board of directors and representatives that wilfully provoked, facilitated, allowed or aggravated the debtor’s economic and financial situation or its insolvency may also be subject to liability. Scholars have concluded that any express decision or omission of the directors that permits the continuation of the insolvent debtor’s operations without adopting any measures directed to address this situation may result in corporate liability under the Argentine General Companies Law. Scholars and recent case law agree that liability requires wilful misconduct. Some case law has shown the imposition of a temporary restraining order on the directors of a bankrupt debtor based on the future and eventual liability actions that might be initiated against them.

iii Clawback

Pursuant to the Argentine Insolvency Law, certain transactions performed by the debtor within the clawback period are void or voidable. The clawback period is the period from, and beginning on, the date on which the debtor becomes insolvent, that is, generally unable to meet its payment obligations – and ending on the date on which the debtor files the petition for reorganisation or the date on which the debtor is adjudicated bankrupt directly. The clawback period cannot extend back for more than two years from the date immediately preceding the date of the filing of the petition for reorganisation or the date of bankruptcy adjudication, in the event of direct bankruptcy.

The following transactions made by the debtor within the clawback period are void: (1) gratuities; (2) advance payments on account of debts that are due on or after the bankruptcy adjudication date; and (3) granting of security (mortgage, pledge or any other preference) in respect of debts not due and not secured under their original terms.

Any other transactions detrimental to the debtor’s creditors made by third parties with knowledge of the debtor’s insolvency during the clawback period are voidable. The third party has the burden of proving that the transaction did not cause any detriment to the debtor’s creditors.

Any transactions in the ordinary course of business made by the debtor or any transactions not within the ordinary course of business and transfers made by the debtor with the authorisation of the court during a reorganisation process or during the implementation of the reorganisation plan are not subject to the avoidance action.

III RECENT LEGAL DEVELOPMENTS

The most relevant recent developments in insolvency law have developed after the financial crisis of the 2000s.

i The amendment of the out-of-court restructuring agreement

Until amendment to the Argentine Insolvency Law in 2002, the out-of-court restructuring agreement was binding exclusively among the consenting creditors. Upon the reform, if the debtor obtains the consent to the out-of-court restructuring agreement by the Requisite Majority of unsecured creditors, it may opt to file it before a competent court for endorsement; upon this endorsement it will be binding against all unsecured creditors.

Almost all restructurings following the Argentine Insolvency Law reform in 2002 were implemented by way of the out-of-court restructuring agreement.

ii The introduction of Section 45 bis to the Argentine Insolvency Law

Until the reform introduced by Law No. 25,589, the consent of all unsecured creditors was computed on an individual basis. Since the reform, the consent to the reorganisation plan or an out-of-court restructuring agreement by the holders of securities issued in series must be given at a meeting of the holders of such securities. Pursuant to Section 45 bis, for the purposes of calculating the Requisite Majority, consent to the reorganisation plan or out-of-court restructuring agreement will be computed on the principal amount represented by all those holders who have accepted the plan; all holders consenting to the plan will be computed as a single person, and all holders rejecting the plan will be computed as a single person.

iii Construction of Section 45 bis

Since the introduction of Section 45 bis, for the purposes of computing the principal amount, in respect of the securities issued in series, the courts have consistently construed that the principal amount of the debt securities, in respect of which the holders thereof have not

5 ibid.
attended the meeting, or have attended but have abstained from voting, will be deducted from the aggregate principal amount outstanding and, therefore, from the base amount to calculate the principal majority.

iv Amendments introduced by the Law to encourage production financing

More recently, in May 2018, the Argentine Congress passed Law No. 27,440, which, among other things, amended the Negotiable Obligations Law No. 23,576, to eliminate the requirement for unanimous approval of any fundamental changes to notes issue conditions. In general, such amendments must be adopted at a meeting of the relevant noteholders. Resolutions, other than those requiring unanimity, are adopted at extraordinary meetings convened with the presence of noteholders representing more than 60 per cent of the aggregate outstanding principal amount of the notes in first call, or more than 30 per cent in the second call, unless, in both cases, the issue conditions require a larger quorum, and with the affirmative vote of the absolute majority of the notes present at the meeting convened with the required quorum. Before this amendment, a restructuring of all outstanding notes could only be pursued following approval of a reorganisation or out-of-court restructuring agreement, by more than 67 per cent of the principal amount, assuming the notes are the only claims subject to restructuring. Pursuant to this amendment, however, in the future, debtors seeking to restructure only notes would no longer be required to file for reorganisation or out-of-court restructuring, and may achieve the restructuring through a resolution at the noteholders’ meeting without the requirement of unanimity, with the majority requirement provided in the notes conditions (which could not be below the statutory majority requirements described above); and excluded certain effects of the Argentine Insolvency Law on derivative transactions after bankruptcy adjudication, such as the restriction on the set-off, the limitations on the agreements with reciprocal obligations pending and agreements with a fixed term.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

Under the current economic conditions, those most affected are small- and medium-sized companies that in the absence of or due to the high costs of external financing, have limited access to group entities’ and shareholders’ financing.

The most active industries are those most affected by the recession, including mainly small- and medium-sized retailers, and particularly the textile, food and home appliances industries, and sectors related to retail such as logistics, transport and other services. Other industries such as the automobile production and sale industry are making personnel suspensions or reductions. One of the measures adopted to reduce the fiscal deficit was the reduction, suspension or delay of some of the government’s programed public works, which also impacted the construction sector. The recession and lack of access to financing at a reasonable cost have mainly affected small- and medium-sized companies. However, towards the end of 2018 and in the first half of 2019, the crisis has begun to affect those large companies that reported losses and have been forced to suspend or reduce personnel.

As a consequence of the foregoing, an increase in restructurings and the filing of crisis preventive procedures before the Labour Ministry has been confirmed. However, a great majority of the companies facing financial trouble have financial debts with local banks and are generally seeking private restructurings out of the remedies of the Argentine Insolvency
Law. In addition, there is also an increase in crisis prevention procedures, which are aimed at implementing a restructuring through the reduction of personnel in order to avoid insolvency or to overcome financial trouble.

Among the largest companies that have gone through the crisis preventive procedures recently we can mention Coca-Cola, Fate and Editorial Atlántida. In addition to the bankruptcy of Cresta Roja and Oil Combustibles, and the out-of-court restructuring of Sancor, more recently there have been other failures of large companies, such as the reorganisations of the low-cost airline Avianca, the transport company ERSA, the retailer of home appliances Ribeiro, the mill Molino Cañuelas and the private restructuring of the retailer of home appliances Garbarino.

V INTERNATIONAL

Argentina has not yet adopted the Model Law on Cross-Border Insolvency of the United Nations Committee on International Trade Law (UNCITRAL), and the main source of law in cross-border insolvency is the Argentine Insolvency Law; except for the treaties of Montevideo of 1889 (between Argentina, Bolivia, Colombia, Peru, Paraguay and Uruguay) and 1940 (between Argentina, Paraguay and Uruguay).

Argentine law voids effects to foreign insolvency proceedings against creditors holding claims payable in Argentina in connection with the dispute of any rights of such creditors on the debtors’ assets located in Argentina, or the annulment of any agreements executed by such creditors with the foreign debtor.

As consequence of this general principle, before any creditor holding claims payable outside of Argentina would attempt to take any action or measure against the foreign debtor’s assets within Argentina, it shall be necessary to verify the existence of creditors holding claims payable in Argentina.

Scholars in general agree that such verification must be made in a court proceeding, but also agree that the Argentine Insolvency Law does not provide for a specific proceeding for this purpose.

Section 4 of the Argentine Insolvency Law provides that the declaration of liquidation in a foreign jurisdiction constitutes grounds for the filing of a petition for a liquidation case of the foreign debtor under the Argentine Insolvency Law, upon which a full plenary liquidation case will be commenced in Argentina.

In addition to the general principle of voided effects of foreign insolvency proceedings against creditors holding claims payable in Argentina described above, the Argentine Insolvency Law comprises three additional principles in cross-border insolvencies:

a preference for creditors participating in the Argentine liquidation process (pursuant to which upon commencement of a liquidation case in Argentina, the creditors participating in the foreign proceeding shall only have the right to get the turnover of the debtor’s remaining assets balance after all the claims of the creditors participating in the Argentine liquidation process have been fully satisfied);

b reciprocity (pursuant to which participation in an Argentine liquidation case of creditors holding claims payable outside of Argentina, and not participating in a foreign liquidation process, is conditioned upon filing of evidence that, reciprocally, creditors holding claims payable in Argentina are permitted to participate in a liquidation process commenced at the jurisdiction where such claims are payable in equal conditions with the domestic creditors of such jurisdiction; however, an exception is made with
respect to creditors holding claims secured by liens on property (mortgages) on real estate property or liens on movable assets. Condition for any creditor be subject to the reciprocity requirement is based on the place of payment of the claim (outside of Argentina) and not on the nationality or domicile of the creditor); and

c. dividend parity (pursuant to which, payment received by unsecured creditors in a foreign jurisdiction after commencement of a liquidation case under the Argentine Insolvency Law will be computed on account of the general distribution available to such creditors on account of payments of unsecured claims under the Argentine liquidation process).

In addition, in the recent case In re Supercanal SA, debtor in a foreign proceeding, in which participated, the United States Bankruptcy Court for the Southern District of New York took a new, more affirmative and innovative approach to granting recognition and relief under Chapter 15 of the US Bankruptcy Code, in reorganisations involving securities issued in series and deposited with depositary systems, where the consideration under the reorganisation plan is tendered and made available to the beneficial owners of the debt securities, and receipt is conditioned upon the performance of certain affirmative actions by such beneficial owners that are never taken. In the relevant portions, the court ordered the discharge of all claims and release of any further obligations by the debtor, securities’ trustees and other securities intermediaries where the exchange of such debt securities could not otherwise have been achieved without action by the beneficial owners. This decision has introduced new features to Chapter 15 recognitions and scope of relief that will facilitate consummating restructurings involving debt securities. The granting by the court of Supercanal’s petitions and relief sought constitutes a milestone in the scope of relief granted under Chapter 15 recognitions.

VI FUTURE DEVELOPMENTS

During the past decades, Argentina has been introducing changes to the Argentine Insolvency Law. The most relevant recent amendments are described above.

The Ministry of Justice has recently convened a number of judges, practitioners, trustees and certified public accountants) to analyse and propose an integral review and amendment to the Argentine Insolvency Law.

The work of such commission has not yet been made public, but the proposed amendments would include, among others:

a. adoption of the UNCITRAL Model Law;

b. development of a procedure for preventing the corporate crisis;

c. creation of a consumer reorganisation proceeding;

d. review of the effects of the insolvency proceedings on the contracts with continuing performances; and

e. DIP financing.

However, as a result of the current economic crisis, these changes have been delayed.
Chapter 2

AUSTRALIA

Dominic Emmett, Peter Bowden and Anna Ryan

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

The Australian economy is continuing to experience sluggish fiscal conditions, with the economic growth rate predicted to decrease from 2.8 per cent in 2018 to 2.1 per cent in 2019. While Australia has not had a technical recession since 1991, businesses appear to be highly vulnerable to economic shocks. Debt levels (especially household debt) have reduced and the property market has seen a sharp decline in what is generally considered to be, a market correction of inflated prices. While the five years leading up to late 2017 saw housing prices increase nationally by over 50 per cent, commentators and trend analysts are forecasting house prices in Australian capital cities will fall by around 7 per cent in 2019, attributing the decline to greater supply, tighter restrictions on lending and increasingly difficult conditions for foreign investors.

Non-traditional lenders continue to make inroads into the corporate and institutional lending spaces, especially in the property and construction sectors. Tightened capital adequacy restrictions as a result of, among other things the Basel Accords, more restrictive prudential standards and internal risk directives have resulted in the partial retreat of banks from these industries. This has encouraged more investment activity from hedge funds, investment banks and alternative capital providers and increased the number of alternative financing arrangements in the leveraged transaction space. For example, financiers in the Australian market are now utilising unitranche facilities that have traditionally been more popular overseas. The adoption of such structures over the past few years has been an interesting development and may pose novel challenges to the Australian debt market in the coming years, should these deals become distressed.

Non-traditional lenders have also benefited from the effects of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission). With the handing down of the final report of the Royal Commission in February 2019, the Australian corporate and banking market has changed, perhaps indefinitely. A key driver of this transformation has been the impact of an increased media spotlight (especially

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Australia

social media) on the behaviour of banks. Reputational risk is heightened and has come to be a primary concern for management and general counsel. A key outcome of the Royal Commission was a renewed focus on regulation, with the final report recommending greater collaboration between the Australian Securities Investment Commission (ASIC) and the Australian Prudential Regulatory Authority. Importantly, the Royal Commission has introduced a shift towards a ‘why not litigate?’ stance regarding ASIC’s enforcement approach and has placed greater scrutiny on regulator performance. This is likely to embolden regulators and increase the level of public oversight.

Because of this increased degree of public and regulatory scrutiny, banks are generally less inclined to enforce security or make formal appointments. This has provided distressed borrowers with more leniency, giving them the opportunity to consult financiers and negotiate alternative measures to deleverage their positions through informal means. With formal insolvency appointments being an unattractive, ‘last resort’ option, the number of secured creditor-led enforcement outcomes (i.e., receiverships) has declined. Some have argued that this is creating a ‘moral hazard’ risk for the banks’ customers. Banks are attempting to mitigate the effects of this shift by working within their customers rather than enforcing; behaviour which does not seem to be changing any time soon.

The changing risk appetite of the banks and the general lending climate has limited opportunities in Australia’s relatively new secondary debt market. While there are proactive buyers present in the Australian secondary debt market, there are generally fewer opportunities to purchase debt. Despite this, in recent years large and complex restructures (i.e., Slater and Gordon and BIS Industries) saw lenders trading their debt to facilitate the transaction; the driver to sell the debt, in those cases, was the banks’ general unwillingness to hold equity in the distressed entities. Considering the relative stability of the Australia banking sector and the robust regulatory framework governing it, secondary debt traders can look forward to comfortably participating in an Australian market that should become more active, if economic conditions continue to decline.

Schemes of arrangement continue to be a popular mechanism for effecting larger and more complex restructures, such as the restructuring of Slater and Gordon, BIS Industries, Quintis Group and Wiggins Island Coal Export Terminal (WICET). While formal appointments (i.e., of liquidators and administrators) may be less common, they are often used as leverage against debtors in restructuring negotiations. Voluntary administration and deeds of company arrangement continue to be frequently used in debt-for-equity swaps; particularly at the small to mid-market level. The main driver for restructures of this type is the power given to deed administrators to compulsorily transfer shares with court approval pursuant to Section 444GA of the Corporations Act 2001 (Cth) (the Act) (if the shares have no ‘economic’ value).

Recently, the mining and mining services, retail and construction sectors have experienced heightened levels of distress. It is expected that each of these sectors (particularly mid-market mining projects and mining services companies in Western Australia) will experience increased levels of restructuring activity.

Despite current trends, breaches of financial covenants, failures to meet amortisation payments or parties inability to refinance, continue to drive a significant proportion of external administration appointments. Where no informal arrangement can be reached between equity, management and lenders, directors will invariably opt to appoint a voluntary administrator over risking liability under Australia’s draconian insolvent trading laws (notwithstanding recent legislative amendments aimed at alleviating such fears, i.e., the...
'Safe Harbour'). This will often result in concurrent appointments where a secured creditor appoints a receiver 'over the top' of a voluntary administrator. Despite the shift in approach from Australian banks, such concurrent appointments still continue to feature in Australia's restructuring landscape.

While seemingly slower owing to several external factors, the insolvency and restructuring market continues to develop and provide opportunities. However, with a more diverse lending market, recent 'Safe Harbour' and *ipso facto* reforms, proposed legislation (i.e., anti-phoenixing legislation) and borrowers remaining susceptible to interest rate rises and other economic shocks, the ensuing years may bring new challenges and give rise to novel trends in the Australian market.

**II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK**

1 Formal procedures

The formal procedures available under Australian law are:

- receivership (both private and court-appointed);
- voluntary administration;
- deeds of company arrangement (DOCA);
- provisional liquidation;
- liquidation (both solvent (members’ voluntary liquidation) and insolvent); and
- court-sanctioned schemes of arrangement between creditors and the company.

For receivership, voluntary administration, DOCA and liquidation, the individual appointed must be an independent registered liquidator, except in the case of a members’ voluntary liquidation.

**Receivership**

The main role of a receiver is to take control of the relevant assets subject to the security pursuant to which they are appointed and realise those assets for the benefit of the secured creditors. One or more individuals may be appointed as a receiver or a receiver and manager of the assets. Despite some historical differences, in practice, it is difficult to distinguish between the two roles and most security interests will allow for the appointment of either. Receivers are not under an active obligation to unsecured creditors on appointment, although they do have a range of duties under statute and common law. Despite being appointed by the secured creditors, a receiver is not obliged to act on the instructions of the secured creditors. A receiver must, however, act in their best interests, and this will invariably lead a receiver to seek the views of secured creditors on issues that are material to the receivership (particularly given a receiver cannot effectively undertake a transaction involving the secured property without a release by, or the consent of, the secured creditor).

There are two ways in which a receiver may be appointed to a debtor company. The most common manner is pursuant to the relevant security document granted in favour of the secured creditor when a company has defaulted and the security has become enforceable. Far less common in practice is the appointment of a receiver pursuant to an application made to

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4 For the purposes of this chapter, the terms ‘receiver’ and ‘receiver and manager’ will be used interchangeably.
the court. Court appointments normally take place to preserve the assets of the company in circumstances where it may not be possible to otherwise trigger a formal insolvency process. Given the infrequency of court-appointed receivers, however, this chapter focuses on privately appointed receivers.

For a privately appointed receiver, the security document itself will entitle a secured party to appoint a receiver, and will also outline the powers available (supplemented by the statutory powers set out in Section 420 of the Act). Generally, a receiver has wide-ranging powers, including the ability to operate the business, borrow against or sell the secured assets. The appointment is normally effected contractually through a deed of appointment and indemnity. By way of the underlying security document, the receiver will be the agent of the debtor company, not the appointing secured party (although this agency relationship will change if a liquidator is appointed to the debtor company, whereby the receiver will become the agent of the secured party).

On appointment, a receiver will immediately take possession of the assets subject to the security. Once in control of the assets, the receiver may elect to run the business (if relevant) if he or she is appointed to oversee all or substantially all of the assets of a company. Alternatively, and depending on financial circumstances, a receiver may engage in a sale process immediately. While engaging in a sale process, a receiver is under a statutory obligation to obtain market value or, in the absence of a market, the best price reasonably obtainable in the circumstances. This obligation is enshrined in Section 420A of the Act. It is this duty that has posed the most significant stumbling block to the adoption of pre-packaged restructuring processes through external administration that have been seen in, for example, the UK market. This is because of the inherent concern that a pre-packaged restructure that involves a sale of any asset without testing against the market could be seen as a breach of the duty under Section 420A. Once a receiver has realised the secured assets and distributed any net proceeds to the secured creditors (returning any surplus to the company or later ranking security holders), he or she will retire in the ordinary course.

Voluntary administration

The concept of voluntary administration was introduced into Australian law in 1993. Voluntary administration, unlike receivership, is entirely a creature of statute, and its purpose and practice is outlined in Part 5.3A of the Act. Voluntary administration has often been compared with the Chapter 11 process in the United States, but unlike Chapter 11, voluntary administration is not a debtor-friendly process. In a voluntary administration, the creditors control the final outcome to the exclusion of management and members. The creditors ultimately decide on the outcome of the company, and it rarely involves returning management responsibilities to the former directors.

The purpose of Part 5.3A is to either:

a maximise the chances of the company, or as much as possible of its business, to continue in existence; or

5 Often referred to as a ‘pre-pack’, this is where a restructure is developed by the secured lenders prior to the appointment of a receiver, and is implemented immediately or very shortly after the appointment is made.

6 The regulation of pre-packs in Australia was flagged in the Productivity Commission’s Report on Business Set-up, Transfer and Closure that was released to the public on 7 December 2015, although no further steps have been taken.
if the first option is not possible, achieve a better return for the company’s creditors and members than would result from an immediate winding up of the company.7

There are three ways an administrator may be appointed under the Act:

a by resolution of the board of directors that, in their opinion, the company is, or is likely to become, insolvent;8

b a liquidator or provisional liquidator of a company may, in writing, appoint an administrator of the company if he or she is of the opinion the company is, or is likely to become, insolvent;9 and

c a secured creditor who is entitled to enforce security over the whole or substantially whole of a company’s property may, in writing, appoint an administrator if the security interest is over the property and is enforceable.10

An administrator has wide powers and will manage the company to the exclusion of the existing board of directors. Once an administrator is appointed, a statutory moratorium is activated, which restricts the exercise of rights by third parties under leases and security interests,11 and in respect of litigation claims, the moratorium is designed to give the administrator the opportunity to investigate the affairs of the company, and either implement change or be in a position to realise value, with protection from certain claims against the company.

There are two meetings over the course of an administration that are critical to the outcome of the administration. Once appointed, an administrator must convene the first meeting of creditors within eight business days (at such meeting, the identity of the voluntary administrator is confirmed, the remuneration of the administrator is approved and a committee of creditors may be established). The second creditors’ meeting is normally convened 20 business days after the commencement of the administration (referred to as the ‘convening period’). The convening period may be extended by application to the court. At the second creditors’ meeting, the administrator provides a report on the affairs of the company to the creditors and outlines the administrator’s views as to the best option available to maximise returns. There are three possible outcomes that can be put to the meeting: entry into a DOCA with creditors (discussed further below); winding up the company; or terminating the administration.12

The administration will terminate according to the outcome of the second meeting (i.e., either by progressing to liquidation, entry into a DOCA or returning the business to the directors to operate as a going concern (although this is rare)). When the voluntary administration terminates, a secured creditor that was estopped from enforcing a security interest due to the statutory moratorium becomes entitled to commence steps to enforce that security interest unless the termination is due to the implementation of a DOCA approved by that secured creditor.

7 Section 435A of the Act.
8 Section 436A of the Act.
9 Section 436B of the Act.
10 Section 436C of the Act.
11 There is, however, an exception to the moratorium on the exercise of rights under security interests in the case of a secured creditor that has security over all or predominantly the whole of the assets of the company and such rights are exercised within the ‘decision period’ (being 13 business days after the appointment of the administrator).
12 Section 439C of the Act.
**Deed of company arrangement**

A DOCA is effectively a contract or compromise between the company and its creditors. Although closely related to voluntary administration, it should, in fact, be viewed as a distinct regime as the rights and obligations of the creditors and company will differ from those under a voluntary administration.

The terms of a DOCA may provide for, inter alia, a moratorium of debt repayments, a reduction in outstanding debt and the forgiveness of all or a portion of the outstanding debt. It may also involve the issuance of shares, and can be used as a way to achieve a debt-for-equity swap through the transfer of shares either by consent or with leave of the court (as noted above). This mechanism has been utilised numerous times to effect debt-for-equity restructures including, for example, in Mirabela, Nexus Energy, Channel Ten and Paladin.

Entering into a DOCA requires the approval of a bare majority of creditors both by value and number voting at the second creditors’ meeting. In order to resolve a voting deadlock, for example, where there is a majority in number but not in value or vice versa, under Rule 75-115(3) of the Insolvency Practice Rules (Corporations) 2016 (Cth) an administrator may exercise a casting vote in order to pass, or not pass, a resolution. The right to exercise a casting vote is not mandatory. A DOCA will bind the company, its shareholders, directors and unsecured creditors. Secured creditors can, but do not need to, vote at the second creditors’ meetings, and typically only those who voted in favour of the DOCA at the second creditors’ meeting are bound by its terms. Unlike a scheme of arrangement, court approval is not required for a DOCA to be implemented provided it is approved by the requisite majority of creditors.

Upon execution of a DOCA, the voluntary administration terminates. The outcome of a DOCA is generally dictated by the terms of the DOCA itself. Typically, however, once a DOCA has achieved its stated aims it will terminate. If a DOCA does not achieve its objectives, or is challenged by creditors, it may be terminated by the court.

A DOCA may also be utilised where the convening period has not been extended and the administrators require more time to sell the business or its assets than provided for in the legislation; for example, an administrator may wish to postpone a sale until market conditions improve, to generate a better return for creditors and might use a DOCA to push out the timeline. Such arrangements are known as ‘holding DOCAs’ and do not generally contain any specific provisions as to the future of the company or, on their face, any benefit for creditors. Their primary purpose is to provide more time for forming and agreeing a restructuring proposal. Holding DOCAs also confer other benefits, including an extension of the moratorium on all creditors bound by the DOCA, time and cost savings on applying

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13 Section 444GA of the Act.
14 There have been two cases challenging the validity of the widely held view that secured creditors are not ‘bound’ by a DOCA unless they vote in favour of it. In *Australian Gypsum Industries Pty Ltd v. Dalesun Holdings Pty Ltd* [2015] WASCA 95 and *Re Bluenergy Group Limited* [2015] NSWSC 977, it was held that a DOCA can (if so expressed) have the effect of extinguishing the debt of a secured creditor that did not vote in favour of the DOCA pursuant to Section 444D(1) of the Act. However, this extinguishment is subject to the preservation of the secured creditor’s ability (by virtue of Section 444D(2) of the Act) to realise or deal with its security in respect of its proprietary interest in the secured property and to the extent that its debt was provable and secured assets were available at the date that debt would otherwise be released under the DOCA, without requiring that that debt be preserved into the future or for other purposes.
for an extension of the convening period and greater flexibility for the administrator. While the use of holding DOCAs has at times been controversial, the court has generally supported their use as a means of facilitating a better result for creditors.

**Provisional liquidation**

A provisional liquidator may be appointed by the court in a number of circumstances. The most commonly used grounds include:

- **a** insolvency;
- **b** where an irreconcilable dispute at a board or shareholder level has arisen that affects the management of the company; or
- **c** if the court is of the opinion that it is just and equitable to do so.

A creditor, a shareholder or the company itself has standing to apply for the appointment of a provisional liquidator, although in most cases a creditor will be the applicant. A provisional liquidator will normally only be appointed by the court if there is a risk to the assets of a company prior to a company formally entering liquidation. As such, a provisional liquidator is normally only given very limited powers (i.e., the power to take possession of the assets), and the main role of the provisional liquidator is to preserve the status quo.

A court determines the outcome of a provisional liquidation. It may order either that the company move to a winding up, with the appointment of a liquidator, or that the appointment of the provisional liquidator is terminated.

**Liquidation**

Liquidation is the process whereby the affairs of a company are wound up and its business and assets are realised for value. A company may be wound up voluntarily by its members if solvent or, alternatively, if it is insolvent, by its creditors or compulsorily by order of the court.

**Voluntary liquidation (members and creditors)**

The members of a solvent company may resolve that a company be wound up if the board of directors is able to give a 12-month forecast of solvency (i.e., an ability to meet all its debts within the following 12 months). If not, or if the company is later found to be insolvent, the creditors take control of the process. Creditors may resolve at a meeting of creditors to wind up the company and appoint a liquidator (this may take place at the second meeting of creditors during an administration). If the requisite approvals are obtained in either a members’ voluntary winding up or a creditors’ voluntary winding up, a liquidator is appointed.

**Compulsory liquidation**

The most common ground for a winding-up application made to the court is insolvency, usually indicated by the company’s failure to comply with a statutory demand for payment of a debt. Following a successful application by a creditor, a court will order the appointment of a liquidator.

In both a voluntary and compulsory winding up, the liquidator will have wide-ranging powers, including the ability to challenge voidable transactions and take control of assets. Generally, a liquidator will not run the business as a going concern, unless it will ultimately result in a greater return to stakeholders. During the course of the winding up, the liquidator...
will realise the assets of the company for the benefit of its creditors and, to the extent of any surplus, its members. At the end of a winding up, the company will be deregistered and cease to exist as a corporate entity.

**Scheme of arrangement**

A scheme of arrangement is a restructuring tool that sits outside formal insolvency; that is, the company may become subject to a scheme of arrangement whether it is solvent or insolvent.

A scheme of arrangement is a proposal put forward (with input from management, the company or its creditors) to restructure the company in a manner that includes a compromise of rights by any or all stakeholders. The process is overseen by the courts and requires approval by all classes of creditors. In recent times, schemes of arrangement have become more common, in particular for complex restructurings involving debt-for-equity swaps, in circumstances where the number of creditors within creditor stakeholder groups may make a contractual and consensual restructure difficult.

A scheme of arrangement must be approved by at least 50 per cent in number and 75 per cent in value of creditors in each class of creditors. It must also be approved by the court in order to become effective. The test for identifying classes of creditors for the purposes of a scheme is that a class should include those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to a ‘common interest’. Despite this long-standing proposition, recent case law has suggested that courts may be willing to stretch the boundaries of what would ordinarily be considered to be the composition of a class and, in doing so, may agree to put creditors in classes even where such creditors within the class appear to have objectively distinct interests.15 Thus, the basis upon which parties have previously grouped creditors into classes is now a less certain benchmark for class composition in the future.

The outcome of a scheme of arrangement is dependent on the terms of the arrangement or compromise agreed with the creditors. Most commonly, a company is returned to its normal state upon implementation as a going concern but with the relevant compromises having taken effect.

The scheme of arrangement process does, however, have a number of limiting factors associated with it, including cost, complexity of arrangements, uncertainty of implementation, timing issues (because it must be approved by the court it is subject to the court timetable and cannot be expedited) and the overriding issue of court approval (a court may exercise its discretion to not approve a scheme of arrangement, despite a successful vote, if it is of the view that the scheme of arrangement is not equitable). These factors explain why schemes of arrangement tend to only be undertaken in large corporate restructures and in scenarios where timing is not fatal to a restructure.

**ii Rights of enforcement**

Secured creditors may enforce their rights in every form of external administration. During a voluntary administration, a secured creditor with security over the whole or substantially the whole of the company’s property may enforce its security, provided it does so within 13 business days of receiving notice of appointment of the voluntary administration, or with

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leave of the court or consent of the administrator. In addition, if a secured creditor takes steps to enforce its security before the voluntary administration commences, it may continue to enforce its security in the ordinary course of business.

Where a company pursues a DOCA, a secured creditor who did not vote in favour of such a proposal will have the ability to enforce its security interests once the DOCA becomes effective.16 If a voluntary administration otherwise terminates, a secured creditor may also commence steps to enforce its security interest upon termination.

iii Directors’ duties in distressed situations

Case law in Australia, particularly the Westpac Banking Corporation v. Bell Group Ltd (in liq) case (Bell),17 has reaffirmed the position that a director must be increasingly mindful of the interests of creditors as a company approaches insolvency. A director’s duty to creditors arises by operation of the well-established fiduciary duty owed by a director to the company more generally. When a company is solvent, the interests of the shareholders are paramount, and conversely, when a company is near insolvency or of doubtful solvency, the interests of the creditors become increasingly relevant. It is important to emphasise that the duty to take into account creditors’ interests is owed to the company, not to the creditors per se.18

The extent of this duty continues to be an evolving area of the law. It is, however, now well established under Australian law that directors must at the very least have regard to the interests of creditors when a company is in financial distress or insolvent. As noted by Lee AJA in Bell:

At the point of insolvency, or the pending manifestation of insolvency, the duty to act in the best interests of each company was of central importance for the companies to comply with statutory obligations and the obligation of the companies not [to] prejudice the interests of creditors.19

Further, it has been suggested that when the solvency of a company is doubtful or marginal, it would be a misfeasance to enter into a transaction that the directors ought to know is likely to lessen the company’s value if to do so will cause a loss to creditors. Directors should not, for instance, allow the company to enter into commitments that it clearly will not be in a position to meet or that may prejudice the interests of creditors generally.

iv Clawback

Under Australian law, transactions will only be vulnerable to challenge when a company enters liquidation. Only a liquidator has the ability to bring an application to the court to declare certain transactions void. In the report to creditors at the second creditors’ meeting, a voluntary administrator may identify potentially voidable transactions, but he or she is not empowered to pursue a claim in respect of such a transaction. Any such claim must be brought by a subsequently appointed liquidator.

There are several types of transactions that can be found to be voidable including:

1. unreasonable director-related transactions;
2. unfair preferences;

16 ibid.
18 Spies v. the Queen [2000] HCA 43.
19 Westpac Banking Corporation v. The Bell Group Limited (In Liq) [No. 3] [2012] WASCA 157 at 920.
Transactions in categories (b), (c) and (d) will only be voidable where they are also found to be ‘insolvent transactions’, that is, transactions that occurred while the company was cash-flow insolvent, or contributed to the company becoming cash-flow insolvent. Each type of voidable transaction has a different criterion and must have occurred during certain time periods in the lead up to administration or liquidation. The relevant time period is generally longer if the transaction involves a related party.

Upon the finding of a voidable transaction, a court may make a number of orders, including directions that the offending person pay an amount equal to some or all of the impugned transaction; directions that a person transfer the property back to the company; or directions that an individual pay an amount equal to the benefit received.

As part of the 2018–2019 Federal Budget, the Australian government announced a series of reforms to combat illegal phoenix activity (i.e., transactions taking place at a time when a company is nearing insolvency that are intended to defeat creditors). As part of the wider reforms, which also proposed civil and criminal liability for directors and advisors engaging in creditor-defeating dispositions of company property, the Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019 (the Bill) proposed legislating a power for liquidators to recover property that is the subject of creditor-defeating dispositions (in line with their existing ability to claw back voidable transactions).

v Insolvent trading

Directors may be held liable for new debts incurred by a company trading while cash-flow insolvent. This potential liability does not extend to debts incurred prior to the date a company became cash-flow insolvent, or recurring payments that become due after that date under the terms of pre-existing arrangements such as rent or interest (i.e., when the liability to pay such amounts already existed at the time of insolvency).

In terms of a director’s personal liability, a court may make an order requiring the director to compensate the company for loss arising out of the insolvent trading, prevent a director from managing a corporation for a period of time and, in rare circumstances where the failure to prevent insolvent trading is ruled as a result of dishonesty, a fine of A$200,000 may be levied against the offending director.

The appointment of a voluntary administrator or a liquidator by the directors protects a director from any claim that he or she allowed the company to trade while insolvent in respect of any debts incurred after the date of such appointment.

With effect from September 2017, new Section 588GA of the Act, provides that a director is not liable for debts incurred by a company while it is insolvent if, ‘at a particular time after the director starts to suspect the company may become or be insolvent, the director starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company’ than the ‘immediate appointment of an administrator or liquidator to the company’. A director that seeks to rely upon Section 588GA(1) of the Act bears the evidential burden in relation to that matter. That is, providing evidence that suggests a reasonable possibility that the matter exists or does not. The safe harbour protection
does not apply in certain circumstances, including where, at the time the debt is incurred, the company has failed to pay employee entitlements or comply with certain reporting or taxation requirements.

In order to assist directors in seeking to ensure they obtain the benefit of the safe harbour protection, the Act lists some indicia for a director to regard when determining whether a course of action is reasonably likely to lead to a better outcome for the company. This includes whether the relevant director is:

- a properly informing himself or herself of the company’s financial position;
- b taking appropriate steps to:
  - prevent any misconduct by officers or employees of the company that could adversely affect the company’s ability to pay all its debts; or
  - ensure that the company is keeping appropriate financial records consistent with the size and nature of the company;
- c obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; or
- d developing or implementing a plan for restructuring the company to improve its financial position.

To date, there has been no case law providing judicial interpretation of Section 588GA as a defence to insolvent trading, including guidance as to how some of the important concepts and terminology associated with the safe harbour provisions should be applied.

### III RECENT LEGAL DEVELOPMENTS

#### i Strengthening protections for employee entitlements

On 5 April 2019, the Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018 (Cth) (the SPE Act) received Royal Assent. The SPE Act introduced, among other things, three significant changes to the Act:

- a an extension of the previous criminal offence provision to capture a person recklessly entering into transactions to avoid the recovery of employee entitlements;
- b enhanced personal liability consequences by introducing a new civil penalty for such action with an objective reasonable person test; and
- c an ability for a liquidator, among others in certain circumstances, to seek compensation for loss or damage suffered because of a contravention of the civil penalty provision.

The SPE Act introduced a new Section 596AB to the Act, which provides for a lower bar for contravention; a person will contravene the offence provision if they enter into a relevant agreement or a transaction and they are reckless as to whether such agreement or transaction will avoid or prevent the recovery of employee entitlements or significantly reduce the amount of the entitlements of employees of a company that can be recovered.

Under the new Section 596AC of the Act, the SPE Act also introduced civil liability for persons who enter into a relevant agreement or a transaction and the person knows, or ‘a reasonable person in the position of the person would know, that the relevant agreement or the transaction is likely to…’ avoid or prevent the recovery of the entitlements of employees of a company or significantly reduce the amount of the entitlements of employees of a company that can be recovered. The new Section 595ACA provides that a person is liable to pay
compensation for any loss or damage suffered by employees resulting from a contravention of Section 596AC while the company is in liquidation, and that a liquidator may recover from the person as a debt to the company the amount of loss or damage.

The SPE Act further introduced a Division 8 of the Act dealing with contribution orders for employee entitlements. Section 588ZA(1) provides that a Court may make an employee entitlements contribution order in relation to an entity where it is satisfied that a company is being wound up; an amount of the entitlements of one or more employees of the insolvent company that are protected under Part 5.8A has not been paid; the contributing party is a member of the same group; has benefited directly or indirectly from work done by those employees; that benefit exceeds the benefit that would be reasonable if the insolvent company and contributing party were dealing at arm’s length; and it is just and equitable to make the order. Section 588ZA(2) of the Act provides that the Court may make an order for a contributing party to pay the liquidator the amount equal to the benefit received by the contributing party that exceeds the ‘reasonable benefit’ that might be expected where the contributing party and the insolvent company were dealing at arm’s length.

While these reforms have yet to be considered by the Courts and, considering the already limited judicial interpretation of the former Section 596AC, it may remain so for some time. It will be interesting to see whether liquidators pursue debts from persons engaging in employee-creditor defeating behaviour.

**ii Combating illegal phoenixing**

As discussed in Section II.iv above, the Bill was recently considered by the Australian parliament. The Bill seeks to introduce reforms aimed at combating illegal phoenix activity; transactions that utilise the insolvency regime to shift assets and defeat creditors.

If passed, the Bill will see the introduction of a new Section 588FE(6B) of the Act, which will provide that creditor-defeating dispositions of company property are voidable where they are made while a company is insolvent or where they cause the company to become insolvent or enter external administration within the 12 months after the disposition. The proposed new Section 588FDB defines a creditor-defeating disposition as ‘a disposition of company property for less than its market value (or the best price reasonably obtainable that has the effect of preventing, hindering or significantly delaying the property becoming available to meet the demands of the company’s creditors in winding-up’.

Similar to the SPE Act, the Bill also proposes to enhance the personal liability consequences for illegal phoenix transactions by introducing both a civil penalty regime and criminal liability (with recklessness being the fault element) for creditor-defeating behaviour conducted by directors or ‘facilitators’ (i.e., pre-insolvency advisors).

The Bill also seeks to introduce a new Section 203AA of the Act to prevent the backdating of director resignations where such resignations are reported to ASIC more than 28 days after their purported occurrence. It also provides that where a resignation would result in the company having no other directors, it will have no effect unless the company is being wound up. These proposed sections seek to address illegal phoenix practices related to backdating the effective date of director resignations to escape liability for the company’s (supposedly) subsequent actions.
IV  SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

In July 2018, amendments to the Act came into operation, introducing an ‘automatic stay’ into the Act on the enforceability of ipso facto provisions that allow a contract to be terminated or altered owing to:

- a company entering into a scheme of arrangement;
- the appointment of a receiver or controller to all or substantially all of the company’s assets;
- the appointment of an administrator to a company; or
- the appointment of a liquidator immediately following administration or a scheme.

The automatic stay does not apply retrospectively (i.e., for agreements entered into prior to the TLA Act coming into force). In addition, the automatic stay does not explicitly apply to:

- receiver or controller appointments that are not over all or substantially all of the company’s assets; entry into a deed of company arrangement; or liquidations which do not immediately follow an administration or scheme.

Under the new Sections 415E and 451F of the Act, a court may lift the automatic stay in respect of certain ipso facto clauses if it is satisfied that doing so is in the interests of justice or where a relevant scheme of arrangement is found to not be for the purpose of avoiding winding up.

The operation of the automatic stay excludes certain rights prescribed in an accompanying ministerial declaration and certain contracts, agreements or arrangements separately set out in Regulations. We also note that the automatic stay does not apply to ipso facto rights attached to financial products that are necessary for their provision, in agreements made after the commencement of the formal restructure or to other types of contracts set out in regulation or declared by the minister.

By way of illustration, some of the contractual rights excluded from the operation of the automatic stay provisions include: (1) a right to terminate under a standstill or forbearance arrangement; (2) a right to change the priority in which amounts are to be paid under a contract, agreement or arrangement; and (3) a right of set-off, combination of accounts or a right to net balances or other amounts.

Similarly, among the agreement types excluded by the Regulations include: (1) contracts, agreements or arrangements that are a licence or permit issued by federal, state or local government; (2) contracts that are derivatives and contracts for the underwriting of an issue or sale of securities or financial products; and (3) contracts under which a party is or may be liable to subscribe for, or to procure subscribers for, securities or financial products.

As the automatic stay provisions have only been in operation for just one year, there has not been any judicial consideration as to the operation of these provisions, including the excluded rights and contract, agreements and arrangements.

V  INTERNATIONAL

Australian courts cooperate with foreign courts and insolvency practitioners, and will recognise the jurisdiction of the relevant court in which the ‘centre of main interest’ is located. This approach follows the UNCITRAL Model Law on insolvency, which was codified into Australian law through the Cross-Border Insolvency Act 2008 (Cth).
There is also scope under different legislation such as the Act for Australian courts to recognise foreign judgments in Australia. Specifically, under Section 581 of the Act, Australian courts have a duty to render assistance when required by a foreign insolvency court. Further, the Act has extraterritorial application; for example, an Australian court has jurisdiction to wind up a foreign company.

VI  FUTURE DEVELOPMENTS

What will be particularly interesting over the next few years will be the impact the *ipso facto* legislation has on restructurings. We also envisage further discussion around potential future reforms to our insolvency laws (which may, for example, seek to facilitate pre-packs); however, any further changes to the insolvency and restructuring legislation, beyond the proposed anti-phoenixing reforms, is unlikely in the 2019 calendar year.

While we are of the view that the safe harbour regime will impact voluntary administration appointments at the small to mid-market level, with some directors willing to seek to rely on the safe harbour and trade the company out of its difficulties, in an environment where there are only very few domestic bank-led receiverships, we anticipate that the number of voluntary administrations will remain constant.

With the number of new entrants entering the leveraged finance market and operating at the higher end of the risk curve, together with the numerous industries continuing to face structural difficulties (e.g., mining, mining services and retail), it would not take much for the needle to turn. We also expect to see a return to banks trading their debt in the near term, and we consider the various overseas participants that are actively present in Australia are here to stay.
Chapter 3

AUSTRIA

Thomas Trettnak and Heinrich Foglar-Deinhardstein

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

In 2018, the number of businesses filing for insolvency decreased slightly. Fewer than 5,000 companies filed for insolvency, the lowest number in the past 20 years. In 2018, 4,980 applications were filed for insolvency proceedings in Austria, down 1.9 per cent compared to 2017. In total, 2,985 companies began insolvency proceedings, while a further 1,995 companies saw their proceedings dismissed because of a lack of assets to cover costs. However, the slight decrease in the number of companies filing for insolvency proceedings is balanced by the increased amount of liabilities and the number of employees affected. Statistics show that liabilities increased by 11.2 per cent to a total of €2,071 million as a result of several major insolvencies, underlining the large amount of debt outstanding in Austria at present. Moreover, the number of employees affected by the insolvency of their employer increased to 19,000 (up 16.6 per cent) compared to 2017 (16,300). In real terms, the number of people affected by insolvencies in Austria has therefore increased rather than decreased.2

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

In insolvency law, Austria is generally considered a creditor-friendly jurisdiction. In order to prevent insolvencies, and to protect the companies themselves and their creditors, the Insolvency Law Amendment Act 2010 entered into force on 1 July 2010.3 It quite comprehensively changed Austrian insolvency law. Since 2010, the Austrian Insolvency Act has provided for uniform insolvency proceedings.4 First and foremost, the new insolvency law aims at encouraging companies in financial distress to use the various procedures for restructuring and protecting insolvency as early as possible. In combination with a mandatory filing requirement, delays in filing for insolvency shall be prevented. The Insolvency Law Amendment Act 2010 was well received throughout the insolvency community and has proved to be a success.

1 Thomas Trettnak and Heinrich Foglar-Deinhardstein are partners at Cerha Hempel Spiegelfeld Hlawati Rechtsanwälte GmbH.
4 Feil, Insolvenzordnung 7, Section 1 FN 1 et seq.
Uniform insolvency proceedings

In Austria, insolvency proceedings are conducted either as restructuring proceedings or as bankruptcy (i.e., liquidation) proceedings.5

Bankruptcy proceedings

This is the most common form of insolvency proceedings in Austria. It aims at liquidating all assets and distributing the funds generated from liquidation to the debtor’s creditors. When opening bankruptcy proceedings, the debtor loses its rights of administration and disposition, which pass to the insolvency administrator. From that point on the debtor remains the owner of the assets, but the assets form the insolvency estate to be used primarily to satisfy the claims of creditors.

Restructuring proceedings

One of the main objectives of the Insolvency Law Amendment Act 2010 was to improve the debtor’s ability to continue as a going concern. Restructuring proceedings encourage a form of debt settlement that is better prepared and, therefore, rapidly finalised. It aims at continuing the operation of the business of the debtor during and after the proceedings, without liquidating the debtor.

If restructuring proceedings fail, they are transformed by court order into bankruptcy proceedings.6 Additionally, the Austrian Reorganisation Act7 also provides – at least in theory – provisions for the restructuring of a company suffering financial difficulties. It is directed at companies that find themselves in an early stage of financial distress. According to the provisions of the Austrian Reorganisation Act, a debt-equity ratio of below 8 per cent and a debt amortisation period of more than 15 years indicate an impending insolvency. However, these provisions have little practical relevance, as the completion of such procedure requires the consent of all creditors.8 Nevertheless, the Austrian Reorganisation Act was prominently used during the Hypo Alpe Adria crisis when the Kärntner Landesholding9 applied for reorganisation proceedings at the competent Regional Court Klagenfurt10 in order to take certain legal measures on behalf of the Kärntner Landesholding and Carinthia in its function as supervisor as well as potential creditors of liabilities facing several claims in connection with the HETA settlement. The respective petition was withdrawn before a decision was made.

Apart from the aforementioned, out-of-court restructuring efforts and negotiations are very common and usually initiated prior to the opening of (in-court) insolvency proceedings,

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5 The Insolvency Law Amendment Act 2010 adapted Austrian insolvency law to the new economic developments and abolished the practically irrelevant composition proceedings. Now, Austrian law provides for certain types of insolvency proceedings which are, however, all governed by the same regulations subject to a few specifics in each case.

6 This is one of the results of uniform insolvency proceedings.

7 Unternehmensreorganisationsgesetz, BGBl. I Nr. 114/1997, as amended.

8 For a comprehensive summary of this ‘stand-alone pre-bankruptcy proceeding’, see Mohr, Unternehmensreorganisationsgesetz – URG (1997).


10 The respective petition can be found at: www.ksv.at/sites/default/files/assets/documents/antrag_auf_einleitung_eines_reorganisationsverfahrens.pdf.
and conducted mostly on an informal basis. However, Austrian law does not know hybrid court-administered restructuring proceedings or insolvency proceedings, such as the German Schutzschirmverfahren (i.e., special pre-insolvency, court-administered proceedings).

ii Test for insolvency

Under the Austrian Insolvency Act, the opening of insolvency proceedings requires either illiquidity\(^\text{11}\) or over-indebtedness\(^\text{12}\) of the debtor.

**Illiquidity**

The Austrian Insolvency Act does not provide any definition of illiquidity. Case law, however, qualifies illiquidity as a permanent lack of funds that prevents the debtor from discharging debts that have fallen due for repayment. Accordingly, the Austrian Supreme Court assumes illiquidity in case the debtor suffers from a permanent lack of sufficient funds. A mere delay in payment does not amount to insolvency. Further, illiquidity is indicated in case there is a liquidity gap of more than 5 per cent of the obligations of the debtor.\(^\text{13}\)

**Over-indebtedness**

This criterion is assessed by means of a two-step test. Austrian law abstains from relying solely on the balance sheets but rather also considers the future commercial opportunities and development of the debtor. Over-indebtedness thus means that the liabilities of a company exceed its assets and that the debtor has a negative going concern forecast. According to case law, the necessity to apply this two-step test is triggered by a finding of negative equity based on the balance sheet of the respective company. Meanwhile, the prevailing view\(^\text{14}\) is that the assets are assessed on the basis of their liquidation value rather than their going concern value. If the company is in a state of calculated over-indebtedness, the second step of the test has to be performed, which has to show a positive going concern forecast (a positive *Fortbestehensprognose*).\(^\text{15}\) The going concern forecast has to assess future solvency and economic viability of the company. A tool commonly used for preparing such going concern forecast is a standardised template of the Austrian Federal Chamber of Commerce detailing the key elements to be set forth therein as well as the methods to be used for the preparation of such a forecast.\(^\text{16}\) In a nutshell, a business plan has to be prepared, showing – with a preponderance of probability – that the company will (1) become and stay solvent within the first six to 12 months following the date of the going concern forecast, and further, in the long term (i.e., two to three years), and (2) be able to achieve economic viability in the form of a sustainable turn-around.\(^\text{17}\) With regard to the required ‘preponderance of probability’, Austrian literature recently criticised the lack of methods to help substantiate this factor. Thus, new ideas are currently being developed in order to help assess the preponderance of probability and,

\(^\text{11}\) Section 66 of the Austrian Insolvency Act.
\(^\text{12}\) Section 67 of the Austrian Insolvency Act.
\(^\text{13}\) OGH 3 Ob 9910/w.
\(^\text{16}\) Leitfaden Fortbestehensprognose Gemeinsame Stellungnahme, March 2016.
consequently, provide sufficient plausibility of the positive going concern forecast. One of those methods frequently discussed in Austria is the ‘Monte-Carlo’ simulation. Given that there is a two-step test, the debtor is not obliged to file for insolvency in case it provides such positive going concern forecast irrespective of whether or not calculated over-indebtedness has been identified.

According to Section 69, Paragraph 2 of the Austrian Insolvency Act, directors of a company are obliged to file for the opening of insolvency proceedings without undue or culpable delay, but in no case later than 60 days after the insolvency criteria are met pursuant to the Austrian Insolvency Act. In bankruptcy proceedings, the application may either be filed by the debtor himself or by a creditor. In contrast, an application for the opening of restructuring proceedings may only be filed by the debtor. Moreover, sufficient assets to cover the costs of the proceedings are required to open insolvency proceedings. In case no sufficient assets are available, the respective insolvency petition is rejected a limine and insolvency proceedings are not commenced. As a consequence, the respective company is dissolved ex officio owing to the lack of funds and deleted from the Austrian Companies Register.

iii Insolvency and restructuring proceedings

The purpose of the Insolvency Law Amendment Act 2010 in particular was to facilitate the reorganisation of a distressed business. Austrian law thus provides for two types of restructuring proceedings. Both are aimed at ensuring the continuing survival of the debtor by providing for the restructuring of (some of its) financial obligations. Simultaneously with the application for the opening of restructuring proceedings, a restructuring plan has to be submitted.

iv Restructuring proceedings with self-administration

This restructuring regime gives the debtor the chance of retaining the administration of its own assets, especially being able to continue to manage its own company. Generally speaking, the restructuring administrator’s approval is required only for matters outside the ordinary course of business. Self-administration requires the debtor to file an application for self-administration supplemented by certain documents and a restructuring plan that provides for a minimum debt repayment quota to the creditors of 30 per cent of registered debt.

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18 Birgmayer-Baier/Piringer/Schützinger, Die Plausibilisierung der ‘überwiegenden Wahrscheinlichkeit’ bei Fortbestehensprognosen durch Monte-Carlo-Simulationen, ZIK 2016/224.
19 See Section 70 of the Austrian Insolvency Act.
20 With regard to companies the initial cost of the insolvency proceeding is estimated at €4,000. It is, however, not necessary that this amount is available in cash. Tangible assets as well as claims against creditors are considered sufficient for this purpose. Whether or not there are sufficient assets has to be assessed ex officio. In case there is a lack of sufficient assets, the competent court requests an advanced payment from the applicant (debtor or creditor). The obligation to provide such an advanced payment relates to the directors as well as shareholders holding a stake of more than 50 per cent.
21 In 2018, a total of 1,995 insolvency proceedings were rejected a limine because the petitioning entity did not have sufficient assets. This accounted for approximately 40 per cent of all insolvency proceedings in Austria in 2018.
22 Restructuring proceedings may already be applied for in case of impending illiquidity.
23 The debtor’s right to keep administering its assets is governed by strict rules and only possible for a very brief period of time (see Sections 169 and 170 of the Austrian Insolvency Act).
The restructuring plan in particular must provide: (1) that the rights of secured creditors as well as the rights of creditors holding a security interest in an asset will not be affected; (2) full payment of all priority claims, any monies advanced by a third party to cover the initial costs of the proceedings and the fees of the administrator; and (3) a quota of at least 30 per cent. Furthermore, the debtor must provide evidence in the application that it is able to fund the priority claims for a period of 90 days following the application.

In order to adopt the restructuring plan, a double majority must be achieved: (1) more than half of the creditors present have to vote in favour of the restructuring plan; and (2) creditors holding more than 50 per cent of the total amount of all current creditors’ claims must consent. The restructuring plan is only adopted if both majorities are achieved; in such a case, dissenting creditors are overruled and have to accept the respective plan.

The restructuring plan has to be approved by the creditors within 90 days of the commencement of restructuring proceedings, otherwise the status of self-administration is lost. However, the proceedings as such still continue as restructuring proceedings with the consequence that the right of administration and disposition pass on to the insolvency administrator.

v Administrated restructuring proceedings
In case the debtor submits a restructuring plan, but does not ask for self-administration, proceedings are opened and called administrated proceedings. The same is true in case the court rejects the debtor’s request for self-administration. In case of administration by a restructuring administrator, the debt repayment quota may be as low as 20 per cent of the registered debt ( repayable within two years). Again, acceptance of the restructuring plan requires a double majority. Administrated restructuring proceedings offer the advantage of a longer period of time for preparing (and financing) a restructuring plan. Hence, the majority of restructuring proceedings are being conducted in this form.

vi General principles
Against the backdrop of wanting to facilitate the reorganisation of businesses, the debtor is also able to submit a restructuring plan even if only ordinary bankruptcy proceedings have been initiated. This is also in the creditor’s interest as the recovery quota is somewhat higher compared to ordinary bankruptcy proceedings. In case the submitted restructuring plan is admissible the court will issue a formal edict opening the proceedings. The court has to set a date for a hearing with regard to the restructuring plan within a period of not more than six weeks. In this hearing the creditors will take a vote on the proposed restructuring plan. In the

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24 Section 169 of the Austrian Insolvency Act.
25 Section 149(1) of the Austrian Insolvency Act.
26 Section 150(1) of the Austrian Insolvency Act.
27 Regardless of this 90-day deadline, the court has the right to withdraw the debtor’s right to self-administer its company inter alia if the debtor does not seem trustworthy, is not paying the priority claims in time or has made incorrect statements in its submission for the opening of restructuring proceedings.
28 Section 141(1) of the Austrian Insolvency Act.
29 In 2018, 346 administrated restructuring proceedings were initiated compared to 46 restructuring proceedings with self-administration. For further details, see the insolvency statistics for 2018 compiled by the Austrian creditors’ representation organisation KSV1870.
30 This can be done until the termination of the proceedings. See Section 140(1) of the Austrian Insolvency Act.
light of achieving better results for creditors, there is a presumption for keeping the debtor's business in operation. The business itself may only be realised: (1) in case the restructuring plan is not approved within 90 days; (2) if the restructuring plan no longer corresponds to the common interest of the creditors; or (3) the requirements for carrying on with the business are no longer fulfilled. In practice, the continuation of the operations of the debtor's business is only possible in case there are additional sources of financing and any further losses can be avoided.

In case the restructuring plan has been approved with the necessary double majority, it is further required to receive the confirmation of the competent insolvency court. The court, however, must not force the creditors to accept the plan. Following the acceptance and confirmation of the restructuring plan, the debtor will (again) be vested with all rights in and to the estate. In certain cases, however, the restructuring plan may also provide for a trustee to be appointed to: (1) supervise the fulfilment of the restructuring plan by the debtor; (2) take over the estate with the mandate to fulfil the restructuring plan; or (3) liquidate the estate.

vii Bankruptcy proceedings

In 2018, for instance, a total of 2,593 bankruptcy proceedings were initiated in Austria, making this liquidation proceeding still the most common type of insolvency proceedings in Austria. In bankruptcy proceedings, the application might either be filed by the debtor himself or by a creditor. The insolvency court has to assess whether the conditions for the opening of the proceedings are fulfilled. In order to avoid that creditor's using filing for insolvency as leverage, the court has to continue with its assessment even if the application has been withdrawn by the creditor as the withdrawal alone does not suffice to rebut the debtor's illiquidity.

In case bankruptcy proceedings are initiated, the insolvency court in any event has to appoint an insolvency administrator. The debtor's right to administer and dispose of the assets passes to the insolvency administrator. Any acts taken by the debtor after the opening of insolvency proceedings are legally void with regard to the insolvency creditors.

The opening of insolvency proceedings is tied to a number of substantive legal consequences that are applicable to all kinds of insolvency proceedings. Once insolvency proceedings are commenced, creditors can only enforce their claims using the rules provided for in the proceedings. Court proceedings and litigation with regard to the insolvency estate are suspended ex lege with the opening of insolvency proceedings; they cannot be commenced or continued. Creditors are further prohibited from obtaining court-ordered security; executions against claims in insolvency are inadmissible. Further, Austrian insolvency law stipulates a bar on dissolving contracts that are essential for carrying on with the business. Basically such contracts – within six months of the opening of insolvency proceedings – may only be dissolved for good cause. In this regard it has to be noted that the deterioration of the economic situation of the debtor as well as the debtor's default in fulfilling claims due before opening insolvency proceedings are not considered to be good causes within the meaning of this provision. Further, there are certain limitations on the creditor's ability

31 Insolvency statistics for 2018 compiled by the Austrian creditors' representation organisation KSV1870.
32 See Sections 6 et seq. of the Austrian Insolvency Act.
33 The restriction set forth in Section 25a of the Austrian Insolvency Act does inter alia not apply to claims for payments from loans and employment contracts.
to use insolvency as grounds for termination of contractual agreements.\textsuperscript{34} With regard to bilateral contracts that neither party has completely fulfilled at the time of the opening of the insolvency proceedings, Section 21 of the Austrian Insolvency Act stipulates that the insolvency administrator may elect to either assume or withdraw from said contract. In case the insolvency administrator assumes the contract, any claims of the contractual partner arising out of this contract constitute priority claims.

\textbf{viii \hspace{1em} The taking and enforcement of security}

The effect of insolvency on security arrangements depends on the exact type of security. The Austrian Insolvency Act distinguishes between the right of separation of assets and the right of separate satisfaction. Generally speaking, both are – subject to voidance claims (see below) – not affected by the opening of insolvency proceedings. In case of an absolute right \textit{in rem} such as in particular retention of title, the respective secured creditor has a claim of separation to receive the asset as this asset does not form part of the insolvency estate.\textsuperscript{35} Claims relating to an absolute right \textit{in rem} are made against the insolvency administrator. Where the insolvency administrator does not release the asset, an action may be brought against the administrator. With regard to claims for separate satisfaction (such as pledges and securities) the creditors are entitled to receive the value of the assets in case they are sold by the insolvency administrator. The amount received when selling such assets serves as a pool of separate assets and the respective creditors are entitled to preferential satisfaction from the sale proceeds. In case the proceeds are insufficient to satisfy the claim, the creditor has to declare the remaining amount as an insolvency claim with the insolvency court.

\textbf{ix \hspace{1em} Duties of directors of companies in financial difficulties}

With regard to management liability, a distinction needs to be made between a director's internal liability in regard to the company and potential external liability in regard to third parties. Under Austrian law, directors are obliged to perform their duties with the care of a prudent and diligent business manager.\textsuperscript{36} Directors may be held personally liable if they negligently or wilfully cause damage to the company. Generally speaking only the company itself, represented by the (remaining) directors, the shareholders or the insolvency administrator is entitled to claim compensation for such damage. Direct claims may be brought by third parties only in specific cases where the director has violated a law protecting the interest of said third parties.

The violation of the director's duty to file for the opening of insolvency proceedings without undue or culpable delay triggers the liability of directors with regard to all creditors for damage caused by such delay, since the respective provision of the Austrian Insolvency Act qualifies as a protective law to the benefit of the creditors. On one side, the protection covers existing creditors (i.e., creditors whose claims existed prior to the opening of insolvency proceedings). Such creditors are entitled to claim the quota damage, which is defined as

\textsuperscript{34} Trettnak, Vertragsauflösung bei Insolvenz erleichtert, Der Standard, 7 April 2014.

\textsuperscript{35} In case the discharge of a secured claim could endanger the business carrying on secured creditors are barred from enforcing their claim prior to the expiry of six months after the restructuring proceedings were opened if such enforcement might endanger the continuation of the debtor's business operations. See Section 11 (2) of the Austrian Insolvency Act.

\textsuperscript{36} See Section 25 of the Austrian Act on Limited Liability Companies and Section 84 of the Austrian Stock Corporation Act.
the damage resulting from the late application for the opening of an insolvency proceeding. Further, also new creditors (who only become creditors after the opening of insolvency proceedings) are protected. In this regard the Austrian Supreme Court has ruled in several cases that (only) the negative interest may be reimbursed.37

The Austrian Criminal Code also contains provisions on insolvency proceedings. The most important provisions are: (1) grossly negligent interference with creditors’ interests;38 (2) fraudulent intervention with a creditor’s claims;39 (3) preferential treatment of creditors;40 and (4) withholding of social security payments.41

x Clawback actions

The Austrian Insolvency Act states that transactions that unduly decrease the assets of the debtor prior to the opening of insolvency proceedings may be contested. All clawback provisions aim to secure the debtor’s assets prior to the opening of proceedings. In this regard, transactions entered into by the debtor and a third party that discriminate against other creditors may be contested.42 The general principles for contesting transactions are as follows: (1) there is a transaction; (2) the transaction is entered into prior to the opening of insolvency proceedings; (3) the transaction unduly decreases the assets of the debtor; (4) the transaction discriminates against other creditors; and (5) a specific contesting provision of the Austrian Insolvency Act is fulfilled. The Austrian Insolvency Act provides for the following contesting provisions:

a Intent to discriminate: This provision applies in case of transactions concluded by the debtor to intentionally discriminate against certain creditors with regard to the others within the past 10 years prior to the opening of insolvency proceedings and if the other contracting party knew of this intent. If the other contracting party should have known of such intent, the period in which to contest the transaction is reduced to two years. Regarding related persons a statutory law provides for a reversal of the burden of proof.

b Squandering of assets: A transaction falls under this provision if the other contracting party must or should have known that the transaction squanders the company’s assets and the transaction was entered into within the last year prior to the opening of insolvency proceedings.

c Dispositions free of charge: This provision relates to transactions that were made free of charge (gifts) and were entered into within the last two years prior to the opening of insolvency proceedings.

d Preferential treatment of creditors: Transactions concluded within the last year preceding the commencement of insolvency proceedings but after material insolvency or the petition for opening insolvency proceedings or in the last 60 days may be challenged if said transaction was objectively preferential or was intended to be preferential and thus discriminates against one creditor with regard to the others.

37 OGH 4 Ob 31/07y.
38 Section 159 of the Austrian Criminal Code.
39 Section 156 of the Austrian Criminal Code.
40 Section 158 of the Austrian Criminal Code.
41 Section 153c of the Austrian Criminal Code.
42 See Sections 27 to 32 of the Austrian Insolvency Act.
Knowledge of illiquidity: A transaction carried out within the last six months preceding the commencement of insolvency proceedings but after material insolvency or the petition for opening insolvency proceedings may be challenged if the other contracting party knew or was negligent in not knowing of the debtor’s illiquidity or the filing of the petition for opening insolvency proceedings, respectively. Further, it is necessary that the respective legal act either constitutes satisfaction or securing of a creditor or is deemed to be disadvantageous.

The claim contesting a transaction must be filed within one year of the opening of insolvency proceedings by claim or objection by the insolvency administrator. It must seek a declaration of ineffectiveness of the contested transaction.

III RECENT LEGAL DEVELOPMENTS

The most recent development in the field of insolvency law in Austria is the comprehensive reform of debt settlement proceedings for natural persons that entered into force on 1 November 2017. Since 1 January 1995, natural persons have had the possibility of debt relief within the framework of debt settlement proceedings.43 This is a special form of insolvency proceedings for natural persons, irrespective of whether they are consumers or individual entrepreneurs. The aim of debt settlement proceedings is to offer an insolvent person a realistic chance to ‘start all over again’ – commercially speaking – and to become debt-free after five years. During this period, a minimum debt repayment quota will no longer be required. The main focus of the reform proposals was the abolition of such a minimum quota of 10 per cent, which was finally implemented into law. Pursuant to the insolvency statistics for 2018, this reform has already had an enormous impact on the local market, as filings have increased by about 45 per cent. In 2018, a total of 10,054 bankruptcy proceedings were filed against natural persons. This was the first time the mark of 10,000 proceedings had been surpassed in Austria. The highest figure prior to this was 9,596 cases in 2011. Furthermore, the debt to be settled in 2018 reached €1,892 million, yet another record. As a percentage, this makes for an astonishing increase in debt of 93 per cent compared to the previous year.

In addition to certain specific topics in company insolvency law, such as the possibility for a call for a debt-to-equity swap for creditors, the introduction of specific hybrid preventative proceedings (similar to the German Schutzschirmverfahren), and group insolvency proceedings are being discussed on an ongoing basis. However, the above are very specific topics that are generally found to be applicable in too few instances that would merit the creation of a specific profound legal basis in Austria. In addition, similar topics are often also discussed at an international or EU level, for example, group insolvency proceedings (see Section V).

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

The most prominent insolvency case in Austria in 2018 was that of Waagner-Biro AG, which filed for administrated restructuring proceedings with the Commercial Court of Vienna on 31 October 2018. According to the Austrian creditors’ representation organisation KSV 43 Sections 181 et seq. of the Austrian Insolvency Code.
1870, this was also the biggest insolvency of the year. With liabilities of €199.3 million, the bridge, steel and stage construction company overtook Austrian Air Berlin subsidiary Niki, which had topped the ranking until recently (more information about the insolvency of Niki can be found in last year’s issue of The Restructuring Review). Waagner-Biro’s steel construction subsidiary SBE Alpha recorded liabilities of €99.4 million and thus had to be closed down immediately after its insolvency proceedings were dismissed because of a lack of assets to cover costs. Its bridge construction subsidiary recorded liabilities of €75 million and the holding company itself was €27.5 million in debt. The fact that a highly specialised and skilled company like Waagner-Biro had liabilities, warranties and other outstanding debts of such a magnitude was somewhat surprising. However, this was the result of two failed multibillion-euro projects: the rooftop of the new Louvre in Abu Dhabi and the construction of the Gazprom headquarters in St Petersburg. In particular, the construction of the steel structure at the Louvre in Abu Dhabi, for which the company had received the European Steel Building Award only one year before, tore a hole in the balance sheet because payments were withheld by the building owner.

The insolvency of MFC Corporate Services GmbH, a provider of trade finance and other services for German Pellets, was the third biggest insolvency in 2018 with recorded liabilities of €150 million. The real estate developer Wienwert recorded €71 million in liabilities and thus takes fourth place in this statistic, followed by Hitzinger, a manufacturer of electric plants, with debts of €40 million. Less extensive in scope, but nonetheless strongly represented in the media was the insolvency of Rosenberger Holding. Rosenberger operated restaurants and petrol stations along motorways all over Austria and was therefore well known to many in Austria. Its restaurant subsidiary, Rosenberger Restaurant GmbH, was able to file for administrated restructuring proceedings and has meanwhile been bought by Burger King which continues to run the motorway restaurants. However, the subsidiary company operating the petrol stations, Rosenberger Tankstellen GmbH, had to file for bankruptcy.

While, historically speaking, the Austrian construction business has been the industry with the greatest number of defaulting companies per year, construction businesses were pushed into second place in the insolvency statistics for 2018. The business-related services industry occupied first place in this unfavourable statistic. This is certainly due to the fact that the business-related services sector is a very large industry including professions regularly carried on by rather small companies or natural persons (e.g., insurance brokers, real estate brokers, real estate developers) without a healthy financial base. The third most affected sector in 2018 was the hospitality industry. Likewise, this can be explained by the sheer number of companies operating in this sector – the hospitality industry is Austria’s largest industry sector by number of competitors – and the small size of the companies in this sector.

V INTERNATIONAL

On 26 June 2017, the recast EU Regulation on Insolvency Proceedings came into force. This new Regulation is applicable to relevant insolvency proceedings from 26 June 2017 onwards. Importantly, the Regulation inter alia establishes new rules for insolvency proceedings opened in relation to a member of a group of companies. The EU has opted for a coordination procedure between the insolvency proceedings involving different companies of the same
group. Furthermore, the new law includes a clarification of the definition of COMI, which is one of the key connecting factors in European insolvency law. The Regulation further provides for two different means to refuse or postpone the request to open secondary proceedings. Generally speaking, however, the reform does not modify, but merely specifies, the fundamental framework of cross-border insolvency adopted by Regulation 1346/2000.45

VI FUTURE DEVELOPMENTS

On 24 May 2018, a revised version of the European Commission’s proposal for a directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures46 was published by the Council of the European Union.47 The Council’s draft is now referred to as the ‘Directive on restructuring, insolvency and discharge of debt’. The European Commission’s initial proposal for this Directive was issued on 22 November 2016. If enacted, the Directive would be the first serious step towards the harmonisation of the domestic insolvency laws of EU Member States. The core element of the proposal sets out rules aimed at ensuring ‘that viable enterprises in financial difficulties have access to effective national preventative restructuring frameworks which enable them to continue operating’. The basic idea is to create a pre-insolvency reorganisation procedure in which the debtor negotiates a plan with creditors or select classes of creditors and that – if voted on by the prescribed majority and approved by designated national administrative agencies – becomes binding, even on dissenting parties to the plan. To facilitate negotiations, the debtor would be able to apply for a stay on enforcement action by creditors, and the commencement of insolvency proceedings. Further, the proposal provides for a safe harbour for transactions that are made in connection with the restructuring and are not carried out fraudulently or in bad faith. Protection is awarded in particular to interim financing and new financing that is granted in connection with a restructuring process. The grantors of such financing are afforded protection against voidance action, as well as liability under criminal or civil law, to which they could be exposed under the existing laws of certain Member States. The Council’s Amendment affects, in particular, the proposed articles on the access to discharge of debt, the discharge period, the disqualification period for insolvent entrepreneurs and the use of electronic means of communication to increase the efficiency of restructuring and insolvency procedures. Those proposals and recommendations are mostly unknown to Austrian insolvency law. Thus, it remains to be seen how the Austrian legislator will transpose those recommendations into national law.

In Austria and with regard to insolvency law, there are no substantial reforms in preparation at the moment. Some minor changes were introduced this year by the Civil Law and Civil Procedure Amendment Act 2019. For example, the amendment clarified that not only natural persons and legal entities but also partnerships can be appointed as administrators in bankruptcy proceedings. Any previous substantial reform projects, such as, for example, the introduction of a debt-equity-swap scheme, are currently in abeyance.

The number of insolvencies depends largely on the performance of the economy and interest rates. Since the economy is not expected to deteriorate in 2019, as Austria’s economy

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45 For a comprehensive overview, see Nummer-Kraugasser/Graber/Jaufer, Grenzüberschreitende Insolvenzen im Europäischen Binnenmarkt (2017).
47 9236/18 ADD 1.
will continue to benefit from the upturn in its eastern neighbour states, and an interest rate hike is not likely until at least 2020, we do not expect a particular increase in insolvencies in 2019. Yet, a further decline is not to be expected either. Rather, there will most likely be a stabilisation at the current number of insolvencies.

However, we believe that a major challenge in Austria in the years to come will be the handling of non-performing loan portfolios of companies across industries, as the total amount of outstanding debt has reached an all-time high in Austria, both in the private and public sector. It may well be expected that increases in interest rates will have a significant and negative impact on debt repayment, and may potentially flood the Austrian market with NPL portfolios.
I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

In 2018, Canada’s economy was growing and the unemployment rate fell to a 40-year low. The Canadian economy was operating close to potential, then slowed in the fourth quarter of 2018. There was a 2.4 per cent increase in insolvency filings. The number of consumer insolvency filings rose 2.5 per cent, which is likely attributable to household debt levels remaining very high. However, the number of business insolvency filings actually fell 0.8 per cent and Canada continues to enjoy low levels of business insolvencies. Many economies experienced a slowdown in late 2018 against a background of high trade uncertainty, tighter financial conditions and political headwinds, but in Canada the deceleration was more severe than elsewhere primarily because of continued low prices for Western Canadian oil.

The Bank of Canada has noted in its most recent monetary report that trade tensions and elevated uncertainty have been important factors weighing on the Canadian economy. Improvements in financial conditions since the beginning of 2019, continuing strong immigration and sustained global expansion are expected to support growth in the near term.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Statutory framework

There are three federal statutes that govern insolvency law in Canada: the Bankruptcy and Insolvency Act (BIA), the Companies’ Creditors Arrangement Act (CCAA) and the Winding-Up and Restructuring Act (WURA).

The BIA, together with its regulations, is a self-contained code that deals with the liquidation of assets and the restructuring of debts of individuals, partnerships, corporations

1 Michael Nowina is a partner, and Alissa Scarcello and Brittany Shales are summer associates at Baker McKenzie.
3 ibid.
5 RSC 1985, c B-3.
6 RSC 1985, c C-36.
7 RSC 1985, c W-11.
(other than certain excluded types of corporations) and other business entities that meet residency and minimal debt requirements. The BIA also provides for receiverships where an insolvent entity's assets and rights are placed in the custody and care of a third party called a receiver. The receiver may continue operations, but more typically, the assets are liquidated.

The CCAA, together with its regulations, deals only with the restructuring of the debts of corporations (other than certain excluded types of corporations) and income trusts that meet certain residency requirements and meet higher minimum debt requirements than those found under the BIA.

The WURA deals with the liquidation and restructurings of certain specified entities, such as banks and trust companies; in effect, all of those entities and corporations specifically excluded from the BIA and CCAA.

Of the three insolvency statutes, the BIA represents the most complete code, providing substantive provisions dealing with, inter alia, the scope and breadth of stays of proceedings, distributional priorities, fraudulent transfers, the sale of assets, the treatment of contracts, interim financings, cross-border proceedings, and penalties and sanctions against debtors and their directors for violations under the BIA. The BIA also contains provisions dealing with the appointment of receivers and the rules regarding their conduct. Restructurings under the BIA are by way of ‘proposals’ to creditors. Such proposals bind all affected creditors, if approved by the requisite double majority (two-thirds of proved claims and over 50 per cent of creditors per class) and subsequently by the court.

The CCAA is a more flexible statute than the BIA, allowing courts more discretion in assisting restructuring corporations. For example, under the BIA, a stay of proceedings is limited to a maximum of six months in a proposal, and the scope of that stay is set out and limited by statute. There is no limit to the maximum cumulative length of a stay of proceedings under the CCAA because the court has significant discretion on the scope of the stay of proceedings beyond what is available under the BIA. Like the BIA, the CCAA also has substantive provisions dealing with distributional priorities, fraudulent transfers, the sale of assets, the treatment of contracts, interim financings and cross-border proceedings. Restructurings under the CCAA are done through a ‘plan of compromise or arrangement’. Such plans, if approved by the requisite double majority (the same as under the BIA), and subsequently by the court, bind all affected creditors.

The WURA is less structured than the BIA or the CCAA and applies primarily to financial institutions. In Canada, the banking system is very stable, and, therefore, there are few proceedings under WURA.

ii Policy

With respect to restructurings, whether it is the debts of an individual or business entity, the objective is to provide a debtor in financial difficulty the time and opportunity to restructure and develop a fresh arrangement with creditors with a view to avoiding a bankruptcy liquidation. The goal is to keep debtors in financial difficulty operating and protected from creditors, in order to allow the debtor to stabilise operations and develop a restructuring plan that may then be put to its creditors for consideration. If the requisite majorities approve the plan, it binds all affected creditors and the debtor emerges from bankruptcy protection and continues its (restructured) operations.
iii Insolvency procedures

To reorganise under the BIA, an insolvent debtor must have liabilities of at least C$1,000, carry on business in Canada and be insolvent. A BIA reorganisation is commenced by a debtor either lodging a proposal to creditors with a proposal trustee or filing what is known as a notice of intention (NOI) to make a proposal under the BIA. If a NOI is filed, the debtor has 30 days to file a proposal, which may be extended by a court order for up to five additional months, in periods of no more than 45 days at a time. If the debtor fails to file a proposal by the end of the final period, or if the proposal is rejected, then the debtor is deemed to have made an assignment into bankruptcy. A stay of proceedings is automatically imposed by statute upon a proposal or NOI being filed.

A bankruptcy liquidation commences with either an assignment into bankruptcy by the insolvent debtor or an application for a bankruptcy order by one or more creditors owed at least C$1,000, where the debtor is insolvent and has committed an act of bankruptcy. Once a bankruptcy order or assignment is made, a trustee is appointed over the assets and is charged with collecting and liquidating the assets of the bankrupt with a view to distributing proceeds to creditors. A meeting of creditors takes place shortly after the bankruptcy, and inspectors may be elected by the creditors to oversee and provide instruction to the trustee on how the proceeding is conducted. Once the assets are liquidated, the trustee distributes the proceeds to creditors who have filed proofs of claim based on the priorities scheme set out in the BIA.

To reorganise under the CCAA, a company must carry on business in Canada, have total liabilities exceeding C$5 million and be insolvent. CCAA proceedings are commenced with a court application by the reorganising debtor for what is known as an ‘initial order’, which establishes the proceeding and sets out the general parameters, including stays of proceedings, provisions that prohibit creditors from enforcing claims against the debtor, provisions that prohibit contracting parties from terminating contracts with the debtor, interim operational matters for the debtor, the appointment of a monitor, and interim financing. Under the new CCAA amendments, after the ten day stay of proceeding, the proceeding may be extended at the discretion of the court for any additional period of time. In the past, reorganisations have taken the form of the development of a plan of compromise or arrangement, consisting of a proposal to creditors to compromise claims. The time frame in which a debtor has to file a plan is in the discretion of the court. Creditors are grouped into classes based on commonality of interest for purposes of voting and distribution under the plan. A majority in number, representing two-thirds in value of the claim of each creditor class, must approve the plan, as well as the court. If they do, then the plan will be binding on all creditors in the class. The CCAA is silent on the time frame to seek court approval.

Under the WURA, depending on the circumstances, a debtor, a creditor, a shareholder or the Attorney General of Canada may commence a proceeding. A stay of proceedings may be sought from the court by the debtor, creditor, contributory, liquidator or the original applicant. The remedy is discretionary. Upon the making of a winding-up order, an automatic stay is imposed. The WURA provides no restrictions on the amount of time a debtor has to restructure or any restriction on the discretion of the court to grant or restrict such time. There is also no time frame for seeking court approval.

In proceedings under the BIA, CCAA and WURA, any affected party may oppose or seek to lift the stay of proceedings. To do so, creditors must prove that they are likely to be materially prejudiced by the continuance of the stay, or it is equitable on other grounds that
the stay be lifted. Unless there are compelling reasons to lift the stay, courts are normally reluctant to do so, especially at the outset of the proceeding, so that the debtor has time to attempt to restructure.

Receiverships can be commenced either under the BIA or under provincial legislation. As an equitable remedy, receiverships take on many forms but typically a receiver is appointed either privately pursuant to a security agreement or by way of court order, and is given certain powers to either operate a business, seize and liquidate assets, or sell a business as a going concern, with a view to distributing the proceeds of sale to the creditors of the debtor. Receiverships are a very common remedy for dealing with insolvency in Canada and a useful tool for monetising the business or assets of an insolvent debtor.

III RECENT LEGAL DEVELOPMENTS

i Orphan Well Association v. Grant Thornton Ltd 2019 SCC 5
The Supreme Court of Canada issued an important decision regarding the intersection between Alberta's provincial oil and gas regulations and the federal BIA. At issue was whether the provincial regulatory regime operationally conflicted with the BIA or frustrated its purposes. In what is commonly referred to as the Redwater decision, the Supreme Court found that there was no conflict and effectively established a super-priority for environmental remediation claims. This means that the bankruptcy trustee of an insolvent company must satisfy the abandonment and reclamation obligations (up to the value of the estate's remaining assets) that are owed to Alberta's environmental regulator before paying the company's creditors.

The practical consequence was that the bankruptcy trustee could not disclaim the spent oil and gas properties and only retain the profitable assets for distribution to Redwater's creditors. Although the trustee remained fully protected from personal liability by the BIA, it could not walk away from the environmental liabilities of the bankrupt estate under the Alberta's regulations. The majority at the Supreme Court looked at the Alberta regulatory regime and concluded that the regime is currently structured to make the costs of abandonment and reclamation part of the overall net value of the licensed assets. The implication is that these amounts were not a 'debt' and the Alberta regulator was not a 'creditor', subject to the priority rules in the BIA.

Redwater has been seen as a strong affirmation of the 'polluter pays' approach to environmental remediation in Canadian law. However, as pointed out by the Supreme Court dissent, the true impact of this decision may well be to displace the 'polluter pays' principle with a 'creditor pays' reality. Creditors of companies in this industry now bear the risk of covering environmental remediation costs, which directly impacts their recovery in a case of insolvency. Going forward, lenders will likely keep the Redwater decision in mind when developing or reviewing their loan portfolios. This may limit the availability of credit for Alberta oil and gas companies in the future.

ii Callidus Capital Corp v. Canada 2018 SCC 47
Canada's Excise Tax Act (ETA) gives the Crown priority over other creditors by virtue of various provisions including a deemed trust imposed by the statute. The issue in this appeal dealt with the effect of the deemed trust when a secured creditor receives proceeds before the bankruptcy. In this case, the debtor had collected amounts pursuant to the ETA, but failed to
remitted those amounts to the Crown. The company partially applied those monies to a secured loan from Callidus. When the debtor entered into bankruptcy, the Crown sued Callidus for the proceeds that the debtor failed to remit on the basis of the deemed trust in the ETA.

The Supreme Court of Canada adopted the dissenting opinion in the Federal Court of Appeal judgment, which ruled that a bankruptcy renders the ETA’s deemed trust ineffective. Therefore, it does not matter if a creditor has received proceeds from a tax debtor’s assets before bankruptcy. This decision means that the Crown cannot recoup from a lender the statutorily required remittances that a bankrupt debtor failed to make to the Crown.

iii Rose of Sharon

In *Rose of Sharon*, the Ontario Labour Relations Board (the Labour Board) examined whether a receivership precluded a union from negotiating a new collective agreement. Rose of Sharon Korean Long-Term Care Home (Rose of Sharon) operated as a long-term care facility. In the same year that the employees joined a union, there was also the court appointment of a receiver over Rose of Sharon. The union filed numerous requests to initiate bargaining for a collective agreement with the receiver, who failed to respond. This led the union to seek a declaration before the Labour Board.

Generally, the purchaser of a business becomes bound by any collective agreement that the seller is a party to, unless the Labour Board declares otherwise. Prior to this decision, it was unsettled in Ontario whether successor rights extended to the context of court-appointed receiverships. The issue in this case was whether the Labour Board was precluded from making a declaration that the receiver was a successor employer. Canadian law protects the receiver from undertaking liabilities that may be imposed under applicable labour legislation. However, the Labour Board determined that the union was not making any claim against the receiver ‘beyond recognition of bargaining rights and the negotiation of a collective agreement’. The Labour Board found that recognition of bargaining rights and negotiation of a collective agreement is ‘not necessarily inconsistent with the purposes of the BIA’. Moving forward, this means that a court-appointed receiver will be required to bargain with a union if it continues to operate a business at least in Ontario.

iv Arrangement relatif à 9354-9186 Québec inc (Bluberi Gaming Technologies Inc), 2019 QCCA 171

The *Bluberi* decision provides important implications for debtors seeking approval for a litigation funding agreement (LFA) in Canada. Bluberi Gaming Technologies (Bluberi) was a company that sold games and casino machines. In August of 2012, the company sought financing from Callidus Capital Corp (Callidus), which provided additional funding. In 2015, Bluberi filed for protection under the CCAA in order to develop a plan of arrangement to its creditors. While the CCAA proceedings were underway, the Québec Court approved a LFA in order to allow Bluberi to pursue a claim against Callidus, which in response sponsored a plan of arrangement to be voted on by creditors. The proposed plan would have provided Callidus with a full release of the litigation claim.

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8 *United Food and Commercial Workers International Union (UFCW), Local 175 v. Rose of Sharon (Ontario)* Community 2018 O.L.R.B. Rep 403, 2018 CarswellOnt 6065 [*Rose of Sharon*].

9 *Rose of Sharon* above at note 39 at Paragraph 73.

10 *ibid* at Paragraph 74.
At the heart of the dispute was an insolvent company that wanted to pursue litigation against a creditor and a creditor that wanted to put forward a plan of arrangement for a vote. In Canada, it is settled law that a creditor can propose a plan of arrangement and every creditor is entitled to vote unless the law specifically precludes such a right. This provides creditors with two basic rights: to participate in the distribution of the debtor’s assets, and, to participate in the decision-making process of the insolvency through the exercise of their voting rights.11 The Québec Court of Appeal determined that Callidus’ plan of arrangement should be submitted for a vote and that Callidus could vote on the plan. Bluberi has sought leave to appeal this decision to the Supreme Court of Canada.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

i Significant transactions

Shortly after its arrival in Canada in 2013, Target decided to wind down its operations in Canada less than two years later and applied for CCAA protection in order to facilitate an orderly withdrawal from Canada.12 This failure was not an isolated incident in the retail environment. In 2017, Sears Canada closed almost 60 of their retail locations across Canada and liquidation sales were implemented at several of the remaining locations.13 The company filed for bankruptcy in 201714 and was followed by the bankruptcy of its parent in the United States approximately one year later.15 Carillion Canada Holdings Inc, a UK subsidiary of Carillion PLC, began proceedings under the CCAA in January of 2018.16 After the UK parent company commenced proceedings, Carillion Canada faced an imminent crisis and resulted in the Canadian filing.17

ii Key developments

Emergence of litigation financing in Canada

Litigation financing agreements (LFA) are relatively novel in Canadian restructuring practice. Despite being widely used in Australia, the United States and United Kingdom, these funding...
agreements are still relatively uncommon in Canada. However, Canadian courts will allow LFAs, provided they do not overreach or interfere with the lawyer client relationship or the administration of justice.

LFAs in a restructuring context originated from *Crystallex* and *Strateco*. In *Crystallex*, the court considered whether the CCAA allowed a judge to approve financing that would continue significantly outside the period of CCAA protection, without approval from the creditors. The case dealt with an interim financing through a specialised lender that was to be used to finance litigation in exchange for the lender receiving 35 per cent of the litigation proceeds. In *Strateco* the court evaluated another interim financing under the CCAA, which was intended to guarantee legal fees for the prosecution of a claim against the government that constituted the debtor’s principal asset. In both cases, the pending litigation was the best chance at recovering any value for the creditors from the insolvent assets and the courts relied on a liberal and purposive interpretation of the CCAA in finding that the financing agreements were in the interest of the creditors. These two cases laid the foundation for *Bluberi*, which is the latest in a string of LFA-type cases in the context of CCAA restructurings. Despite the developments in case law, the use of LFAs in Canada is still limited and the rules are relatively undefined. This is an area that will continue to develop since LFAs are an attractive option for insolvent parties lacking the resources to pursue and monetise litigation claims.

**iii  Most active and distressed industries**

In 2018, the Canadian economy experienced activity and growth with an overall decline in business insolvency filings as compared to 2017. The industries with fewer insolvency filings include: manufacturing, mining, oil and gas, and wholesale trade. Two industries that were more distressed were construction and real estate.

**V  INTERNATIONAL**

Plenary proceedings in Canada may only be commenced by debtors resident in, carrying on business in, or having assets in Canada. A debtor that has no presence in Canada may not commence a plenary proceeding. Where a debtor carries on business in more than one location, the courts will look at factors such as the location of main operations, the location of management, the location of the majority of creditors and convenience for the majority of stakeholders. Canadian courts have generally expressed a willingness to assist foreign courts where such assistance would not contravene public policy concerns in Canada.

With the adoption of most of the UNCITRAL Model Law on Cross-Border Insolvencies in 2009, Canadian courts are now mandated to cooperate with foreign courts, subject to public policy concerns, once an ancillary proceeding is commenced. Pursuant to these regimes, proceedings ancillary to both foreign main and foreign non-main proceedings may be commenced in Canada. Neither the BIA nor the CCAA contain time frames or time restrictions for any such filings. Ancillary proceedings may be commenced by a foreign

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18 *Re Crystallex International Corporation, 2012 ONSC 2125 [Crystallex International], [2012] SCCA No. 254 [Crystallex]; Strateco Resources inc./Ressources Strateco inc. (Arrangement relatif à), 2015 QCCS 4671 (CanLII) online.*
19 Statistics Canada above at note 2.
20 Statistics Canada above at note 2.
representative, which is a party appointed in the foreign proceeding. An automatic stay is granted if the proceeding is recognised as a foreign main proceeding, and a discretionary stay may be granted if the proceeding is recognised as a foreign non-main proceeding.

VI  FUTURE DEVELOPMENTS

Both the BIA and the CCAA contain provisions that mandate their review every five years. Recent proposed amendments to the BIA and CCAA are making their way through the legislative process, but it is unclear when this legislation will become proclaimed in force.21

Pursuant to the proposed amendments, all parties participating in insolvency proceedings under the BIA and CCAA would be required to act in good faith.22 Additionally, to increase corporate oversight, under BIA proceedings, courts would have the power to inquire into ‘payments made to directors or officers of a corporation in the year prior to insolvency, and impose liability on the directors for those payments’.23

The proposed CCAA amendments would reduce the initial stay of proceedings period from 30 to 10 days, and only in times of ‘reasonable necessity’ for the operations of the debtor company.24 The changes aim to limit requests by the debtor for substantial relief from a court with little or no notice to affected parties. Moreover, courts would also be permitted to make an order to a party to disclose any aspect of their economic interest in respect of a debtor company. Federally incorporated firms would also be required to disclose their policies pertaining to workers, pensioners and executive compensation. The proposed changes stem from a goal to make insolvency proceedings ‘fairer, more transparent and more accessible for pensioners and workers’.25

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23 Bill C-97 above at note 30, 6 June 2019 amendment.
24 Bill C-97 above at note 30, Section 136 and 137.
25 Budget above at note 31, p. 67
I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

State of the economy and the finance industry

In 2016, the British electorate, consulted in a nationwide referendum, decided that the United Kingdom (UK) should leave the European Union (EU) (‘Brexit’). Decades of foundational assumptions in public policy and the making and administration of laws were thus overturned. It is now, however, nearly three years since the Brexit referendum, and the date on which the UK was originally meant to formally leave the EU (29 March 2019 at 11pm London time) has elapsed without the occurrence of Brexit. At the time of writing, the EU had agreed to a six-month extension of exit day to 31 October 2019 at 11pm London time, subject to prior ratification by the British Parliament of the ‘EU withdrawal agreement’ (the Withdrawal Agreement) and political declaration on the future relationship between the UK and the EU negotiated by the British government. Those documents – the first, a legally binding text that sets the terms of the UK’s exit from the EU and, the second, a statement on the proposed long-term relationship between the UK and EU, have been rejected several times in the House of Commons, and negotiations between the primary UK political parties have not resulted in an agreed plan as to how certain terms of the Withdrawal Agreement may be renegotiated or how Brexit will alternatively be effected. The impact of Brexit and the eventual status of the UK with regard to the EU thus remains uncertain.

Despite the UK’s decision to leave the EU, in a survey of financial industry professionals conducted by financial advisory firm Duff & Phelps in April 2018, London was voted the world’s leading financial centre for the first time since 2013. Participants in the survey referred, among other factors, to the unique advantages of the English legal system and London’s legal and professional service culture. These, and other factors in London’s favour, will remain largely unaffected by Brexit, at least in the short to medium term.

In terms of domestic economic conditions, after many years of benign inflationary conditions, the UK’s inflation rate rose during 2017 and 2018 as a result of many factors including a weakening in the value of sterling against other major currencies. This led to the Bank of England raising its base rate from 0.25 per cent to 0.5 per cent in November 2017, and then further raising the rate to 0.75 per cent in August 2018. According to the Bank of England’s Inflation Report of May 2019, economic growth in other countries slowed in 2018, reducing demand for the UK’s exports, which consequently became a contributing
factor to the UK’s economy growing at a slower pace. Investment by businesses fell in 2018, but spending by households proved robust, rising 1.7 per cent. In the first quarter of 2019, the UK’s GDP is expected to have grown by 0.5 per cent, in part reflecting a larger-than-expected boost from companies in the UK and the EU building stocks ahead of recent Brexit deadlines; however, that boost is expected to be temporary with quarterly growth predicted to slow to around 0.2 per cent in the second quarter of 2019. The Bank of England also predicts that most of the increase in inflation due to the fall in the pound following the Brexit vote has now occurred, with consumer price inflation at 1.9 per cent in March 2019 and the expectation that the rate will remain slightly below the Bank of England’s target of 2 per cent in the first half of its current forecast period, reflecting lower retail energy prices. The Bank’s forecast is that future interest rate rises over the next few years will be gradual and limited in order to maintain its target inflation rate.

While the overall outlook for the UK economy remains cautiously positive, the long-term economic outlook will be largely dependent on the nature and timing of Brexit, and in particular on the new trading arrangements between the EU and the UK. In the event that economic conditions worsen, or a further rise in interest rates negatively impacts highly geared businesses, the UK’s restructuring and insolvency sector continues to be well prepared to respond to any challenges, albeit that (as explained in more detail in this chapter), the regulatory framework in the UK is undergoing fundamental changes, first in terms of the potential changes that will occur if the current framework for ongoing civil judicial cooperation between the UK and the rest of the EU ceases to apply – which would be the case if the UK leaves the EU without agreement (a ‘no-deal’ Brexit) – and, second, in light of a concerted effort for reforms to be introduced to the restructuring and insolvency framework to provide best-in-class tools for restructuring cases.

ii Market trends in restructuring procedures and techniques employed during this period

According to the Insolvency Service’s Insolvency Statistics report for October to December 2018, 17,439 companies entered into insolvency in England and Wales in 2018, a rise of 0.7 per cent on 2017. Though total liquidations fell by 0.5 per cent to 15,618, there was an increase of 11.1 per cent in compulsory liquidations to 3,117 and a decrease in creditors’ voluntary liquidations of 3 per cent to 12,501. Compared with 2017, administrations in 2018 increased by 11.2 per cent, and company voluntary arrangements increased by 16 per cent. The upshot of these results was that the estimated underlying liquidation rate in 2018 was one company liquidation per 249 of active companies, up from one in 264 in 2017.

The results in the Insolvency Service’s Insolvency Statistics report for January to March 2019 shows that the above trend has continued at the start of 2019, with 4,187 total underlying company insolvencies in England and Wales in the first quarter of 2019 (representing a 6.3 per cent increase on the final quarter of 2018, and a 5.1 per cent increase on the first quarter in 2018), driven by a 6.2 per cent increase in creditors’ voluntary liquidations, 21.8 per cent increase in administrations (resulting in the highest quarterly level in five years since January to March 2014) and 43.1 per cent increase in company voluntary arrangements (CVAs) in relation to the fourth quarter of 2018. The breakdown by industry reveals that the ‘wholesale and retail trade; repair of vehicles’ industry grouping saw the largest increase in underlying insolvencies, with 67 extra cases compared to the 12-month period ending 31 December 2018. This was closely followed by the ‘administrative and support services’ grouping (66 additional insolvencies); manufacturing (58 additional insolvencies); and the ‘accommodation and
food services’ grouping (57 additional insolvencies). The construction industry continues to remain the sector with the highest number of new company insolvencies, with 3,013 insolvencies (excluding bulk insolvencies) in the 12-month period ending 31 March 2019, a 0.6 per cent increase on the equivalent period ending 31 March 2018.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Secured creditors and the balance of power

The approach of the UK’s legal system to the insolvency of troubled businesses is, in part, a product of the secured credit markets in which it developed. The comprehensive security available to lenders in the UK and the rights afforded to them in the event of insolvency go some way to explaining the conventional categorisation of the UK as a ‘creditor-friendly’ jurisdiction, as opposed to one generally regarded as favouring debtors, such as the United States.

A bank lending money to a UK corporate enterprise will typically take fixed and floating charges2 over the company’s assets and undertaking as security for repayment of the debt. The holder of a valid floating charge is generally entitled to be repaid in priority to unsecured creditors,3 but ranks behind fixed charge holders and certain categories of preferential creditors in respect of its claim. The holder of a valid fixed charge is generally entitled to be repaid out of the proceeds of the realisation of its security in priority to all other claims on the company’s assets. The holder of a qualifying floating charge has the right to appoint its own administrator to enforce its security where the debtor is in default. Further, while a company may also be put into administration by court order or by an out-of-court procedure, a floating charge holder will in most cases have the right to choose which administrator is appointed.

ii Statutory insolvency regimes

Corporate insolvency law in the UK has well-developed rules governing the collection and distribution of the assets of an insolvent company on a winding up. The main statutory sources of corporate insolvency law are the Insolvency Act 1986 (the IA86) and the Insolvency Rules

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2 While a fixed charge attaches to a particular asset and allows its disposal only with consent of the secured creditor or on repayment of the debt, a floating charge is created over a class of assets, present and future, and allows the debtor to carry on its business and deal with such assets until a default under the relevant loan agreement (or other defined event), upon which the charge ‘crystallises’ and attaches to the secured assets, preventing the debtor from dealing with the assets without repayment of the debt or consent of the creditor.

3 However, where assets are subject to a floating charge created on or after 15 September 2003, a liquidator, receiver or administrator must in general make a ‘prescribed part’ of the floating charge realisations (currently 50 per cent of the first £10,000 and 20 per cent of the remainder, capped at £600,000) available for the satisfaction of unsecured debts in priority to the claim of the floating charge holder. In August 2018, in response to the March 2018 consultation on the corporate insolvency framework in the UK (discussed in further detail below), the UK government announced plans to potentially increase the maximum size of the prescribed part from £600,000 to £800,000.
2016 (the IR 2016), which supplement the IA86 by providing the procedural framework for the insolvency regime. Parts IV and V of the IA86 sets out the circumstances in which a company may be wound up on a compulsory or voluntary basis.

Compulsory liquidation involves the company being wound up by an order of the court following the petition of an interested party, most commonly on the grounds of an ‘inability to pay debts’. The company is ‘unable to pay its debts’ for these purposes under certain statutory criteria, including under the ‘cash-flow’ test (i.e., where the company is unable to pay its debts as and when they fall due) and the ‘balance sheet’ test (i.e., where the company’s assets are less than its liabilities, taking into account contingent and prospective liabilities). There is no stay or moratorium on the enforcement of security, but it is not possible to commence or continue proceedings against the company without the leave of the court.

Voluntary liquidation is commenced by a resolution of the company and does not generally involve the court. The procedure will be a members’ voluntary liquidation where the directors are prepared to make a statutory declaration that the company will be able to pay its debts in full, together with interest at the official rate, within a period of 12 months from the commencement of the liquidation. Where the directors are not prepared to make such a declaration, the liquidation will proceed as a creditors’ voluntary liquidation. In a members’ voluntary liquidation, the members of the company appoint the liquidator, whereas in a creditors’ voluntary liquidation, both the members of the company and its creditors nominate their choice of liquidator, with the creditors’ choice prevailing in cases of disagreement.

Administration is a mechanism to enable external management of a financially distressed company through the appointment of an administrator, who takes control of the company for the benefit of all creditors, while steps are taken under the protection of a statutory moratorium to formulate a strategy to address the company’s insolvency. An administrator may be appointed to manage the company with a view to achieving one of three statutory purposes, arranged hierarchically as follows:

\[ a \text{ } \text{rescuing the company as a going concern}; \]
\[ b \text{ } \text{achieving a better result for the company’s creditors as a whole than would be likely if the company were wound up (without first being in administration); or} \]
\[ c \text{ } \text{realising property in order to make a distribution to one or more secured or preferential creditors.} \]

The administrator may only perform his or her functions in pursuit of the objective stated in (b) above if he or she believes that it is not reasonably practicable to achieve the objective stated in (a), and to do so would achieve a better result for the creditors as a whole. The administrator may only, in turn, perform his or her functions in pursuit of the objective stated in (c) above if he or she believes that it is not reasonably practicable to achieve the

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4 The IR 2016, which came into force on 6 April 2017 replaced the Insolvency Rules 1986 and the 28 amending instruments thereto in their entirety in order to consolidate and update the insolvency procedural framework. The revised rules (which have been clarified by additional statutory instruments which have subsequently come into force) provide, among other things, for: the abolition of creditors’ meetings as the default method for decision-making in insolvency procedures; the ability to communicate and file forms electronically; split voting rights; and a reduction in the burden of reporting and record-keeping requirements for insolvency practitioners.

5 Paragraph 3(1), Schedule B1 to the IA86.

6 Paragraph 3(3), Schedule B1 to the IA86.
objectives stated in (a) or (b), and to do so would not unnecessarily harm the interests of the creditors of the company as a whole. Therefore, the administrator’s primary objective is now the rescue of the company as a going concern.

An administrator may propose an arrangement under Part 1 of the IA86 (a CVA) or Section 895 of the Companies Act 2006 (a scheme of arrangement or scheme), under which a reorganisation or compromise may be effected; these procedures also exist independently of administration. A scheme or a CVA (each discussed in further detail below) may be invoked whether or not the company is in fact insolvent, and can be used in conjunction with or to avoid administration or liquidation. In each case, the arrangement will be binding on the company’s relevant creditors if the requisite majorities of the appropriate classes vote in favour of the proposals at duly convened meetings and, in the case of a scheme, it is sanctioned by the court.

iii Role of directors

Insolvency law in the UK strikes a balance between facilitating an equitable distribution of the estate to creditors and providing a platform to encourage debt recovery and scrutinise the actions of the directors. Although the current administration regime was introduced in the IA86 to facilitate the rescue of viable businesses, it was done at a time when corporate failure was generally associated with mismanagement and concerns over director misconduct led Parliament to take a strict approach with regard to errant directors. Accordingly, it was decided that the powers of the directors should effectively cease on the appointment of an administrator, who in turn would be given wide powers to carry on the company’s business. Although the directors may remain in control of the company during proposals for a scheme or CVA if those proposals are made outside of administration, the company will not benefit from a statutory moratorium on debt enforcement, unless the company is a ‘small’ company (as defined in the IA86), in which case it may benefit from a limited CVA moratorium.

As a result of reforms introduced at the same time as the CVA and administration procedures, directors of insolvent companies may face disqualification from holding office in future and find themselves personally liable for ‘wrongful trading’ in circumstances where they continued to trade their business despite it being in the twilight of insolvency. This test is set out in Section 214 of the IA86, and provides that a director may be held personally liable for a company’s debts where, knowing there was no reasonable prospect of the company avoiding insolvent liquidation, he or she failed to take every step that he or she ought to have taken with a view to minimising losses to creditors. Directors may also face personal liability in circumstances where they have been found guilty of fraudulent trading under Section 213 of the IA86 or misfeasance under Section 212. In addition, although the codification of directors’ duties under the Companies Act 2006 did not include a specific duty to creditors,

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7 Paragraph 3(4), Schedule B1 to the IA86.
8 CVA proposals must be approved by a simple majority in value of the members and three-quarters in value of the company’s creditors present and voting, provided that not more than 50 per cent by value of the total unconnected creditors vote against the CVA proposal. A scheme requires approval by a majority in number representing three-quarters in value of the members or creditors (or of each class of members or creditors) who vote at a meeting convened by the court for the purpose of considering the scheme. The scheme must subsequently be approved by the court.
9 By the Enterprise Act 2002. Schedule B1 to the IA 1986 sets out the administration regime which applies to all administrations commenced after 15 September 2003.
Section 172(3) of the Companies Act 2006 provides that the duty to promote the success of the company has effect subject to ‘any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company’. Successive English cases since the 1980s have established that directors of a UK company owe common law duties to creditors where the company is insolvent or close to being insolvent. However, there has historically been some uncertainty as to how close to insolvency the company has to be before the duty is invoked. In the leading case of BTI 2014 LLC v. Sequana SA,\textsuperscript{10} the Court of Appeal held that the most appropriate test is ‘whether the directors knew or should have known that the company was, or was likely to become, insolvent’.

iv Claw-back actions

In addition to taking action against errant directors, the liquidator or administrator of an insolvent UK company may apply to the court to unwind certain transactions entered into by the company prior to the commencement of formal insolvency proceedings. A transaction entered into within a particular time frame before the onset of insolvency could be unwound, for example, if it constituted a ‘transaction at an undervalue’ or a ‘preference’.

A transaction at an undervalue involves a gift by a company, or a company entering into a transaction where it receives no consideration or consideration of significantly less value than the consideration given by the company. A preference involves putting a creditor (or a surety or guarantor for any of the company’s debts or liabilities) in a better position than the creditor would otherwise have enjoyed on an insolvent winding up. A court will not generally intervene, however, in the case of a transaction at an undervalue, if the company entered into the transaction in good faith for the purpose of carrying on its business and at the time it did so there were reasonable grounds for believing the transaction would benefit the company, or, in the case of a preference, if the company was not influenced by a desire to prefer the creditor, surety or guarantor in question. In the absence of fraud, a transaction will also not normally be unwound if the company was not insolvent at the time of the transaction and did not become so as a result of it.

The court also has the ability to make an order to unwind a transaction if it is satisfied that the transaction was entered into to defraud creditors by putting assets beyond the reach of claimants against the company or otherwise prejudicing their interests. No time limit applies for unwinding such a transaction.

Floating charges created by an insolvent company in the year before the insolvency are invalid, except to the extent of any fresh consideration, namely the value of the consideration given to the company by the lender when the charge was created. This period is extended to two years where the charge was created in favour of a connected person.

III RECENT LEGAL DEVELOPMENTS

i Impact of Brexit

The European Union (Withdrawal) Act 2018 (the Withdrawal Act) received Royal Assent on 26 June 2018, providing for the repeal of the European Communities Act 1972 on the day the UK leaves the EU (at the time of writing, 31 October 2019 at 11pm, subject to any prior

\textsuperscript{10} [2019] EWCA Civ 112.
agreement on the Brexit withdrawal deal) and converts into UK domestic law the existing body of directly applicable EU law. The Withdrawal Act provides for the passing of secondary legislation to address failures of this retained EU law to operate effectively.

The Bank Recovery and Resolution and Miscellaneous Provisions (Amendment) (EU Exit) Regulations 2018/1394, adopted on 20 December 2018, are an example of such secondary legislation, with an aim to ensure that the UK’s special resolution regime continues to operate effectively after the UK leaves the EU and independently of the Bank Recovery and Resolution Directive 2014/59/EU (BRRD). The BRRD, which entered into force on 2 July 2014 and was implemented in the UK through the amendment of the Banking Act 2009 and other existing UK legislation to establish the UK’s special resolution regime, aims to provide EU Member States with a common framework for the resolution of banks and investment firms, as well as ensuring cooperation between Member States, and with third countries, in planning for and managing the failure of cross-border firms. As the BRRD itself will not be retained in UK law after the UK leaves the EU, the new regulations seek to remove the deficient references to the BRRD from UK law such that the UK’s special resolution regime is legally and practically workable on a standalone basis following the occurrence of Brexit. The regulations also set out the information that is to be contained in a recovery plan or group recovery plan, the additional information that may be required for a resolution plan or group resolution plan, and matters that the Bank of England is to consider when assessing resolvability. Following the UK’s withdrawal from the EU, the UK will retain its third-country recognition framework (with certain amendments) and expand its scope to include EEA-led resolutions.

**Brexit impact on civil justice and judicial cooperation, and insolvency legislation in the UK**

In the event that the Withdrawal Agreement is ratified by the British Parliament, several existing EU regulations will continue to apply in the UK for the duration of the applicable transition period set out therein including Regulation (EU) 2015/848 on Insolvency Proceedings (the Recast Insolvency Regulation)\(^\text{11}\) and Regulation (EU) 2015/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast) (the Recast Brussels Regulation).\(^\text{12}\)

In the event that the UK’s exit from the EU is not supported by a deal (i.e., with no Withdrawal Agreement, transition period or political declaration on the framework for the future UK–EU relationship), however, several UK statutes that currently rely on reciprocity from the EU or individual EU Member States would require fundamental amendment to reflect the new standalone paradigm. In particular, the restructuring and insolvency

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\(^{11}\) Article 67(1)(a) of the Withdrawal Agreement provides that the provisions regarding jurisdiction of the Recast Brussels Regulation shall apply in the UK, as well as in Member States in situations involving the UK, in respect of legal proceedings instituted (and proceedings or actions related to them) before the end of the transition period. Article 67(2)(a) of the Withdrawal Agreement further provides that the provisions of the Recast Brussels Regulation regarding the recognition and enforcement of judgments in legal proceedings instituted before the end of the transition period shall apply in the UK, as well as in Member States in situations involving the UK.

\(^{12}\) Article 67(3)(c) of the Withdrawal Agreement provides that the EU Insolvency Regulation shall apply to insolvency proceedings, and any action which derives directly from the insolvency proceedings and is closely linked with them (such as avoidance actions), provided that the main proceedings were opened before the end of the transition period.
framework in the UK would be fundamentally affected in a no-deal Brexit scenario by:
(1) the Civil Jurisdiction and Judgments (Amendment) (EU Exit) Regulations 2019 (which
was published in draft on 12 December 2018) (the Judgments EU Exit Regulations); and
(2) the Insolvency (Amendment)(EU Exit) Regulations 2019/146 (the Insolvency EU Exit
Regulations) made on 30 January 2019.

Judgments EU Exit Regulations
If enacted, the Judgments EU Exit Regulations would, in the event of a no-deal Brexit,
44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of
judgments in civil and commercial matters (which applies to judgments given in proceedings
commenced before 10 January 2015), and amend the domestic legislation13 implementing
the Brussels Convention 1968, Lugano Convention 2007 and the EU/Denmark agreement
of 19 October 2005. These EU regulations and treaties (referred to, collectively, as the
‘Brussels regime’) regulate jurisdiction and the recognition and enforcement of judgments in
civil and commercial matters, operating largely on a reciprocal basis between Member States.
In the event that the UK exits the EU without a future agreement on the continued operation
of the Brussels regime, this reciprocity would be lost, meaning that the Judgments EU Exit
Regulations would be necessary to avoid inappropriate or unworkable unilateral application
of these rules by the UK following exit (subject to certain saving provisions for cases which
are ongoing as at exit day).14

In place of the Brussels regime, the government has stated that it would revert to the
rules that apply to cross-border disputes where the Brussels regime does not apply: that is,
the common law rules and (where it applies) the Hague Convention on Choice of Court
Agreements 2005 (to which the UK intends to accede as a contracting state (discussed in
further detail below)), given that those rules do not require reciprocity.

Insolvency EU Exit Regulations
The Insolvency EU Exit Regulations are intended to address the deficiencies that would arise
in a no-deal Brexit scenario from the absence of mutual application of the Recast Insolvency
Regulation. Absent the Insolvency EU Exit Regulations, the UK would be bound to continue
to recognise insolvency proceedings in the remaining EU Member States under the UK’s
retained version of the Recast Insolvency Regulation but Member States would not be bound
to recognise UK proceedings or the claims of UK creditors, unless their own domestic law
provided for such recognition.

In a no-deal Brexit scenario, the Insolvency EU Exit Regulations amend the retained
Recast Insolvency Regulation that is incorporated into domestic law on exit day pursuant
to the Withdrawal Act by disapplying virtually all of its provisions such that the UK would

13 Including: (i) the Civil Jurisdiction and Judgments Act 1982, (ii) the Civil Jurisdiction and Judgments
Order 2001/3929 and (iii) the Civil Jurisdiction and Judgments Regulations 2009/3131.
14 The saving provisions will provide that the Brussels regime will continue to apply to proceedings
commenced before exit day which have not yet been concluded, judgments obtained in proceedings
commenced before exit day in an EU Member State or a state applying one of the other Brussels regime
instruments where a party wishes to obtain recognition or enforcement of that judgment in the UK, or
where the parties have come to a court settlement or have registered an ‘authentic instrument’ before exit
day and one party wishes to obtain recognition and enforcement in the UK after exit day.
not be obliged to recognise Member State insolvency proceedings (unless a different basis for recognition, such as the Cross-Border Insolvency Regulations 2006, applies). In essence, pursuant to the Insolvency EU Exit Regulations, the UK would retain a modified version of the Recast Insolvency Regulation’s jurisdictional tests of ‘COMI’ and ‘establishment’ as bases for jurisdiction to open insolvency proceedings, which would be in addition to the UK’s domestic provisions on jurisdiction. The Insolvency EU Exit Regulations would provide clarity on the status of UK insolvency orders in cases where the debtor has its COMI or an establishment in the UK, which may assist foreign courts when assessing whether to recognise those UK orders in their jurisdiction. The Insolvency EU Exit Regulations would also make consequential amendments to existing domestic legislation including the IA86.

ii Government responses to consultations on corporate insolvency framework

On 26 August 2018, the UK government’s Department for Business, Energy and Industrial Strategy (BEIS) published the UK government’s responses to (1) the 25 May 2016 consultation from the Insolvency Service, entitled ‘A Review of the Corporate Insolvency Framework: A consultation on options for reform’ and (2) the 20 March 2018 consultation from BEIS, entitled ‘Insolvency and Corporate Governance: a consultation’. In response to the May 2016 consultation, which had received comments from stakeholders across the UK insolvency community, the government has said that it will introduce:

a a new statutory moratorium available for all companies that will become insolvent if action is not taken, but which are not yet insolvent, preventing creditor action against the company, overseen by an officer of the court with the title of the monitor;

b legislation to prevent the enforcement of contractual termination clauses in contracts for the supply of goods or services, or for contractual licenses, that are triggered by the entry of a contracting party into formal insolvency proceedings, a pre-insolvency moratorium process (see above), or a restructuring plan process (see below); and

c a standalone procedure whereby a company (whether it is solvent or insolvent) can propose a restructuring plan to its creditors, whether or not in tandem with a standalone moratorium (see above). The new procedure is modelled on the existing scheme of arrangement process under Part 26 of the Companies Act 2006, including the categorisation of creditors into classes for voting purposes, save that the new procedure will adopt features which are equivalent to provisions of Chapter 11 of the US Bankruptcy Code in allowing for the confirmation of the plan even where a class of creditors has voted against it, subject to satisfaction of certain conditions.

The March 2018 consultation was launched following a number of high-profile insolvencies of major UK companies, including well-known high-street retailers, and allegations of mishandling by management and shareholders. The stated aim of the consultation was to reduce the risk of major company failures occurring through shortcomings of governance or stewardship and to strengthen the responsibilities of directors of firms when they are in or approaching insolvency. In response to the March 2018 consultation, the government

15 The Insolvency Exit Regulations contain transitional provisions which provide that the Recast Insolvency Regulation would continue to apply where main proceedings were opened before exit day, as would the EC Regulation on Insolvency 1346/2000 (the 2000 Insolvency Regulation) where proceedings were opened before 26 June 2017 (the date when the 2000 Insolvency Regulation was superseded by the Recast Insolvency Regulation).
has stated that it will take forward a number of specific actions relating to various corporate governance matters in the face of company insolvencies, including work to strengthen oversight of group structures, strengthening investor stewardship (including through enforcement of the Financial Reporting Council’s revised UK Corporate Governance Code, published in July 2018), consideration of the suitability of the current regime regarding the determination for payment of dividends and the considerations for directors of a holding company selling a financially distressed subsidiary.

On a wider EU level, in March 2019, the European Parliament approved the Directive on preventative restructuring frameworks, second chances and measures to increase the efficiency of restructuring, insolvency and discharge procedures, and amending Directive 2012/30/EU (the Directive on Preventative Restructuring Frameworks). The main objective of the Directive on Preventative Restructuring Frameworks is to reduce the most significant barriers to the free flow of capital stemming from differences in Members States’ restructuring and insolvency frameworks. Although the legislation will not be implemented by the UK following Brexit, the reforms put forward in the government’s response to the BEIS’s March 2018 consultation appear to align with the recently approved directive. For example, the Directive on Preventative Restructuring Frameworks seeks to implement, inter alia:

- a stay to cover individual enforcement actions and the opening of insolvency proceedings where they may adversely affect a restructuring, suspending the obligation of a debtor to file for insolvency; and
- a framework for the adoption of restructuring plans, whereby any affected creditors should have the right to vote on the adoption of a restructuring plan, but the plan may still be approved by a cross-class cramdown procedure.

It therefore seems that, even following Brexit, the UK will look to position its restructuring regime in alignment with the harmonised regimes of European Member States. However, as highlighted above and discussed in more detail below, the loss of the current reciprocal recognition arrangements in a no-deal scenario may lead to restrictions in cross-border situations in the future.

iii Modified universalism

A significant feature of English restructuring law over the last couple of decades has been the concept of ‘modified universalism’, which holds that, in cross-border insolvency matters, it is inherently desirable for all claims against the insolvent entity to be dealt with in the same process and in one jurisdiction, and hence that under the common law (i.e., where statute law is silent on the subject), courts should be ready to assist foreign insolvency officeholders where appropriate in the conduct of the insolvency.

However, modified universalism arguably reached its high-water mark in the cases of Cambridge Gas Transport Corp v. Official Committee of Unsecured Creditors of Navigator
England and Wales

Holdings plc and Re HiH Casualty and General Insurance Ltd; McMahon v. McGrath, given that in subsequent cases such as Rubin and Another v. Eurofinance SA and others and Singularis Holdings Ltd v. PricewaterhouseCoopers, the English courts have taken a more cautious approach. It is now clear that (1) no special common-law rules apply permitting judgments in respect of avoidance actions in foreign insolvency proceedings to be recognised where foreign judgments would not be recognised or enforced outside of an insolvency context, and (2) while the court has a power to assist foreign winding-up proceedings, the power is circumscribed by, among other things, the limitations of the law that applies to those foreign proceedings.

The concept of modified universalism has been examined again recently at both first instance and appeal in Re OJSC International Bank of Azerbaijan in the context of determining whether the rule in Antony Gibbs & Sons v. Societe Industrielle et Commerciale des Metaux (the Gibbs rule) still applies under English law. As discussed in further detail below, both courts upheld the Gibbs rule despite accepting that ‘[it] may be thought increasingly anachronistic in a world where the principle of modified universalism has been the inspiration for much cross-border cooperation in insolvency matters’.

IV KEY RESTRUCTURING TOOLS, SIGNIFICANT DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

i The importance of the ‘pre-pack’

The term ‘pre-pack’ is typically used in UK insolvencies to describe the sale of a distressed business where all the arrangements of the sale are negotiated and agreed before the company enters a formal insolvency procedure (typically administration), and the sale is concluded by the insolvency practitioner very shortly thereafter. This allows the business to survive relatively intact while allowing it to jettison a proportion of its debts. The increase in popularity of pre-packs appears to reflect a market demand for a restructuring remedy that allows key creditors to play a central role.

On the one hand, pre-pack sales provide for a relatively rapid and straightforward business transfer without the damaging publicity and consequent harm to reputation caused by a typical insolvency process. On the other hand, critics argue that the process lacks transparency, is controlled by senior lenders, sidesteps procedural safeguards inherent in the administration process and offers no guarantees that the interests of all creditors will be properly taken into account. Pre-packs have also attracted criticism owing to a high number of sales to connected parties such as management (known as ‘phoenix’ sales) and the fact that the insolvent company may often move straight to dissolution following the sale (without a separate liquidator being appointed).

17 [2007] 1 AC 508, PC.
18 [2008] 1 WLR 852, HL.
20 [2015] AC 1675, PC.
21 [2018] EWHC 59 (Ch) and [2018] EWCA Civ 2802.
22 (1890) 25 QBD 399.
23 In general terms, the Gibbs rule provides that a debt that is governed by English law cannot be discharged by foreign insolvency proceedings.
24 [2018] EWCA Civ 2802 at [31].
However, in many cases, particularly when a company has no cash available, pre-packs provide the only solution to saving most of the business, the company’s goodwill and allowing employees to continue working. As a result, dozens of high street names have been resurrected under pre-pack deals in the past few years, including La Senza, JJB Sports, Agent Provocateur, Bernard Matthews, Silentnight and Debenhams.

In an attempt to address some of the concerns surrounding the use of pre-packs, the Insolvency Service Statement of Insolvency Practice 16 (January 2009), a revised draft (1 November 2015) and the Insolvency Code of Ethics for England and Wales have been published and adopted to improve the transparency and propriety of pre-packs and to help insolvency practitioners meet the standards of conduct expected of them by providing professional and ethical guidance.25

In terms of the case law treatment of pre-packs, the use of a pre-pack was explicitly approved in the case of Re Hellas Telecommunications (Luxembourg) II SCA,26 where the High Court granted an administration order in respect of the Greek telecommunications company Wind Hellas (which was incorporated in Luxembourg) and expressly granted the company’s administrators liberty to complete a pre-pack sale of the company’s assets. The judgment is significant as it was the first case where the court expressly supported a pre-pack sale.

In Capital for Enterprise Fund a LP and another v. Bibby Financial Services Ltd,27 the High Court held that a director had breached his fiduciary duties by not informing the other directors of the proposed pre-pack sale and prioritising the preservation of the company’s business, which was not in the best interests of either the company or its creditors. The case thus serves as a useful reminder of the need for a director of a company in financial difficulties to distinguish between the interests of the business of the company and that of the company and its creditors.

ii CVAs

The retail industry experienced continued restructuring activity in the second half of 2017 and early 2018, with 43,000 retailers ending the first quarter of 2018 in financial distress. Several unfavourable factors affected British retail companies alongside the 2016 Brexit referendum result, including the introduction of the national living wage (which increased by 4.4 per cent in April 2018) and surging consumer debt levels which contributed to the weakening of the value of sterling. Additionally, loss of momentum in the housing market appears to have hit consumer confidence, with households expecting their disposable income to fall this year despite the fact that real earnings are rising, according to the April 2018 PwC Consumer Survey. The continued expansion of online retailers’ market share and rising rent costs and business rents also continue to put pressure on the high street.

25 The recent case of Re Ve Interactive (in administration) [2018] EWHC 196 (Ch) demonstrates that the English courts are willing to remove and investigate administrators (as well as directors) in the event of a mishandling of pre-pack sales. Ve Interactive, which was valued at £1.5 billion in 2016, was sold by administrators for £1.75 million plus other consideration in a pre-pack sale to a new company connected to the company’s management, which had mismanaged the company and incurred substantial liabilities. The High Court held that the administrators should be removed for breaching their duty to act in the best interests of the company’s creditors, for being ‘blind’ to the potential for a conflict of interest when selling a company in distress to its former management and for the mishandling of the bid process.
26 [2009] EWHC 3199 (Ch).
27 [2015] EWHC 2593 (Ch).
A corollary of the recent financial difficulties in the retail sector has been the re-emergence of the CVA, an insolvency procedure that allows a voluntary compromise to be reached to repay business creditors some or all of the debt owed. Well-established brands, such as BHS, Maplin, Homebase, Toys ‘R’ Us, House of Fraser, Carpetright, Prezzo, Poundworld and New Look proposed CVAs between 2016 and 2017, with further high-profile examples such as Debenhams and Arcadia Group in the first half of 2019.

CVAs are well suited to retail businesses as they allow for the closure of underperforming stores, negotiation of rent reductions with landlords and alteration of management teams, all while the business continues to trade. It is noted, however, that a number of companies whose CVAs were approved have nonetheless subsequently failed where the proposed go-forwards business plan, product offering and/or customer proposition was fundamentally deficient, resulting in a financially unviable business. The success of a restructuring case involving a CVA is therefore intrinsically tied to the company implementing a wider operational turnaround in addition to the compromise imposed by the CVA in order to achieve future financial viability.

### Schemes

Schemes, alongside the US Chapter 11 procedure, are the pre-eminent tool for implementing complex restructurings of the financial liabilities of multinational companies. Over recent years, they have been increasingly used in restructurings involving foreign as well as domestic companies.

A scheme can be used to achieve anything that a company and its creditors or members may lawfully agree among themselves. In significant balance sheet restructuring cases, the most common arrangement or compromise for schemes has involved the compromise of claims of the scheme creditors (financial institutions which have provided secured funding to the company) through a debt-to-equity swap. The main objective of a debt-to-equity swap is to provide a struggling company with a strengthened balance sheet and improved liquidity. Debt-to-equity swaps can be used both in consensual circumstances and in non-consensual circumstances as dissenting creditors can be ‘crammed down’ by a scheme provided the requisite percentage and number have approved the scheme and it has been sanctioned by court. There will often be ‘out of the money’ creditors when debt-to-equity swaps are being implemented by schemes, and in such situations it may be necessary to use a transfer scheme.

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28 This is on the basis that those dissenting creditors are grouped together in a voting class with supporting creditors who together constitute a majority in number and hold at least 75 per cent in value of the claims of the voting members of the class. The statutory voting threshold must be met in each scheme voting class, meaning that it is not possible for ‘cross-class cramdown’ as is permissible under a Chapter 11 plan of reorganisation. This approach is further in contrast to the proposed standalone restructuring procedure (discussed in further detail above), which will allow cross-class cramdown in order for the plan to be approved if certain conditions are met.

29 The English courts have paid closer attention recently to issues of fairness when considering sanctioning schemes. For example, the judgments in *Privatbank* and *Indah Kiat* demonstrate that the courts are unwilling to fracture classes where creditors who have different rights prior to the scheme would rank pari passu in an insolvent liquidation. The courts have also considered whether ‘lock-up fees’ (also known as ‘consent fees’ or ‘work fees’), which are offered to consenting creditors who enter into a binding agreement to support the restructuring, fracture the class. In *Privatbank*, Richards J proposed that the test that may be applied in relation to consent fees is whether it will have a material effect on the decision of a creditor to support the scheme. In this instance, the 2 per cent fee was not considered to breach the ‘materiality’ threshold.
In these circumstances a scheme may be used to cram down any ‘in the money’ creditors in conjunction with a pre-pack to transfer the scheme company’s assets to a new company, thereby leaving ‘out of the money’ creditors with claims against the scheme company with no assets.

Schemes are increasingly being considered by foreign companies that can establish a connection to the UK owing to the lack of a local equivalent that would enable them successfully to restructure their debts without the unanimous consent of their creditors. Foreign companies have been allowed to avail themselves of English law schemes where they can demonstrate both a ‘sufficient connection’ with England and Wales, and where the scheme order would be effective in the jurisdiction in which the company would otherwise be wound up. Following schemes in relation to Re Tele Columbus GmbH, Re Rodenstock GmbH and Primacon Holding GmbH v. A Group of the Senior Lenders & Credit Agricole, it has become a well-trodden path for the English courts to exercise their scheme jurisdiction over foreign companies on the basis that there is a sufficient connection. This can be achieved where the scheme involves English law-governed finance documents, such as in Re Public Joint-Stock Company Commercial Bank ‘Privatbank’ and in Re Codere Finance (UK) Limited schemes. The English courts have also been satisfied that a ‘sufficient connection’ with England can be established by amending the governing law and jurisdiction clauses of the debt documents to English law, as demonstrated in Re Apcoa Parking Holdings GmbH and others and in Re DTEK Finance BV schemes. Often this type of amendment will require the support of two-thirds of the lenders. Another means of establishing jurisdiction is to shift the COMI of the company to the UK, as was done successfully in the restructuring of Wind Hellas and in the Re Magyar Telecom BV scheme.

Though the application of the Recast Brussels Regulation has not been finally determined in relation to schemes, foreign scheme companies have typically relied on Articles 8 (domicile) and 25 (exclusive jurisdiction) to establish the jurisdiction of the English courts. Article 8 provides that a defendant may be sued in an EU Member State where at least one ‘defendant’ (treating scheme creditors as defendants) is domiciled, provided that ‘the claims are so closely connected that it is expedient to hear and determine them together’. The

30 Following the success of schemes of arrangement in the UK, a number of jurisdictions (such as the Netherlands and Singapore) have recently implemented reforms to their restructuring frameworks. Such reforms have included the adoption of a procedure similar or identical to the UK’s scheme of arrangement in part or in full in order to benefit from the increasing global demand by companies for this popular and flexible restructuring tool. However, the UK remains the most popular forum to effect a scheme as it has been well-tested in the English courts, and the case law continues to evolve in response to the practical and commercial needs of distressed companies.

31 [2014] EWHC 249 (Ch).
32 [2011] EWHC 1104 (Ch).
33 [2012] EWHC 164 (Ch).
34 [2015] EWHC 3299 (Ch).
35 [2015] EWHC 3778 (Ch).
36 [2014] EWHC 3849 (Ch).
37 [2015] EWHC 1164 (Ch).
38 [2013] EWHC 3800 (Ch).
39 For example, where the relevant documents contain an exclusive jurisdiction clause pursuant to which parties have agreed that the courts of a particular Member State are to have jurisdiction to settle disputes.
judgments in *MetInvest*,40 *Hibu*41 and DTEK suggest that only one scheme creditor must be domiciled in England and Wales, whereas *Re Van Gansewinkel Groep BV and others*42 and *Re Global Garden Products Italy SpA (GGP)*43 suggest that Article 8 may require consideration of ‘the number and value of the creditors domiciled in the UK’.

Article 25 is potentially engaged where the relevant documents contain an exclusive jurisdiction clause pursuant to which parties have agreed that the courts of a particular Member State are to have jurisdiction to settle disputes. In *Hibu*, Warren J found that Article 25 can apply to asymmetric jurisdiction clauses despite such jurisdiction clauses only binding one of the parties to a particular jurisdiction rather than both parties. However, in *GGP*, Snowden J found that Article 25 did not confer jurisdiction in respect of ‘asymmetric’ jurisdiction clauses. Following *CBR Fashion*,44 and the recent scheme judgment of Snowden J in *Re Noble Group Limited*,45 which note the conflicting views in those cases, it remains unclear which interpretation should prevail.

In the event that the Recast Brussels Regulation ceases to apply in the UK following a no-deal Brexit, the above questions would cease to be relevant to schemes, thereby leaving the sufficient connection test as the clear test for the court to exert jurisdiction. As discussed further below, however, this may also have a significant impact on the recognition of schemes across the EU.

iv Hot industries

The retail industry has seen continued restructuring activity through 2018, for the reasons discussed above, in addition to newer challenges including online competition and changing consumer habits. As a result, the second half of 2018 saw well established retailers such as House of Fraser, Evans Cycles, and HMV enter restructuring or insolvency procedures, or being sold in distressed M&A deals. Meanwhile, the consumer industry, in particular the casual dining sector, also showed signs of distress through 2018, with the number of restaurant businesses going bust reaching its highest level since 2010, jumping by more than a third in 2018, according to Debtwire’s Distressed Market Outlook 2019. Restaurant chains Gaucho and Byron are just two examples of such businesses that have struggled, while the Jamie’s Italian chain filed for administration in May 2019.

The oil and gas sector remains volatile – while 2018 saw increased activity in the oil services sector and a recovery of the oil price, the price fell back to below US$50 a barrel at the end of the year, with Ocean Rig, Pacific Drilling and SeaDrill entering restructuring processes in 2017, and Dolphin Drilling entering the process in 2018. The weakness of the oil price at the end of 2018 has meant that the oil sector has not recovered as much as hoped.

40 [2016] EWHC 79 (Ch).
41 [2014] EWHC 370 (Ch).
42 [2015] EWHC 2151 (Ch).
43 [2016] EWHC 1884 (Ch).
44 [2016] EWHC 2808 (Ch).
45 [2018] EWHC 3092 (Ch). Snowden J’s convening hearing judgment ([2018] EWHC 2911 (Ch)) and sanction hearing judgment ([2018] EWHC 3092 (Ch)) in relation to the *Re Noble Group Limited* scheme further provide instructive analysis on the court’s jurisdiction in relation to schemes proposed by foreign companies, class issues, the role of the court at each hearing, procedural matters, and questions relating to the fairness of the terms of the scheme.
The automotive industry also faces challenges as a result of factors including the likely long-term shift to electric cars, the supply chain risks in the event of a hard Brexit, and a change in consumer preferences with younger people favouring ride hailing and sharing services over car ownership.

The property and construction industry continues to be affected by the collapse of the UK’s second-largest construction company, Carillion, in January 2018. The business had close to £1 billion in debt when it failed, leaving thousands of companies and contractors in its supply chain at a loss. One stark example is Balfour Beatty, the UK’s largest construction company, which anticipated a £45 million hit as a result of Carillion’s failure. Carillion’s insolvency is likely to continue to have far-reaching implications for the UK economy, as a large proportion of its business was made up of government contracts, including the provision of services to Network Rail, the NHS and UK schools and prisons. In May 2019, British Steel Limited, the UK’s second-largest steelmaker, filed for liquidation following the collapse of negotiations between British Steel Limited’s owner and the UK government to inject fresh capital into the business (which had just weeks before the filing received a £120 million loan from the government to help it meet payments to an EU environmental scheme) to stave off the problems caused by a drop in orders by European customers due to the uncertainty caused by the Brexit process.

V INTERNATIONAL

The main sources of cross-border insolvency law in the UK are the Recast Insolvency Regulation, the Cross-Border Insolvency Regulations 2006 (SI 2006/1030) (the CBIR), which implement the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law), Section 426 of the IA86 and the underlying common law. As discussed elsewhere in this chapter, the framework applicable to cross-border insolvencies may be subject to significant change in the coming years as a result of the UK’s decision to leave the EU.

i Recast Insolvency Regulation

The Recast Insolvency Regulation, which came into effect from 26 June 2017, replaced the 2000 Insolvency Regulation. The fundamental premise that insolvency law is a matter for each EU Member State has remained embedded within the Recast Insolvency Regulation, and the Recast Insolvency Regulation seeks to strengthen the framework of recognition and cooperation between EU Member States. The Recast Insolvency Regulation introduces the following key measures:

- measures to discourage abusive forum shopping, namely by changing the presumptions applied in relation to the location of COMI;46
- a new procedure, known as a ‘group coordination proceeding’, which will allow for coordination on insolvencies of groups of companies, in which group members can choose to participate;47
- pre-insolvency rescue proceedings to be included in the definition of main proceedings, as the scope of proceedings is broadened. Secondary proceedings will no longer be

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46 ibid, Article 3.
47 ibid, Chapter V.
limited to winding-up proceedings. For the UK, however, schemes of arrangement under Part 26 of the Companies Act 2006 will remain outside the scope of the Recast Insolvency Regulation;\textsuperscript{48} provision for a court to be able to postpone or refuse a request to open secondary proceedings. In certain situations, an office holder of the main proceedings may, with the support of local creditors, give an undertaking as to the treatment of creditors in other Member States in order to avoid secondary proceedings in those jurisdictions. Various other mechanisms have been introduced to minimise the need to open secondary proceedings;\textsuperscript{49} and in the EU-wide insolvency registers to be established so that they are searchable in all official languages of the EU (although these provisions will not come into force at the same time as the majority of the new provisions).\textsuperscript{50}

In relation to the determination of a company’s COMI, the leading authorities under the Insolvency Regulation are the rulings of the European Court of Justice in Re Eurofood IFSC\textsuperscript{51} and Interedil Srl (in liquidation) v. Fallimento Interedil Srl and another.\textsuperscript{52} In Eurofood, it was held that the presumption in Article 3(1) that a company’s COMI is situated in the state where it has its registered office can only be rebutted if there are factors, objective and ascertainable by third parties, that enable this to be established to the contrary. The Eurofood test was subsequently applied by the English High Court in Re Stanford International Bank Limited and others.\textsuperscript{53} Interedil established the principle that in determining a company’s COMI under the Insolvency Regulation, more weight must be given to the location of the company’s central administration in accordance with Recital 13 of the Insolvency Regulation (which states that a debtor’s COMI must correspond to the place where it regularly conducts the administration of its interests).

\begin{itemize}
\item \textbf{ii CBIR}
\end{itemize}

The CBIR enacted the Model Law in the law of Great Britain (i.e., England, Wales and Scotland) in April 2006. The CBIR provide, inter alia, for the recognition of a foreign proceeding commenced or officeholder appointed in any foreign jurisdiction, regardless of whether that foreign jurisdiction has enacted a version of the Model Law.

The CBIR have been successfully used to obtain recognition from the English courts of insolvency proceedings in the BVI,\textsuperscript{54} Denmark,\textsuperscript{55} Switzerland,\textsuperscript{56} Antigua,\textsuperscript{57} Croatia,\textsuperscript{58} Azerbaijan\textsuperscript{59} and other countries.

\textsuperscript{48} ibid, Articles 1 and 3.
\textsuperscript{49} ibid, Article 36.
\textsuperscript{50} ibid, Articles 25–30.
\textsuperscript{51} Case C-341/04.
\textsuperscript{52} Case C-396/09.
\textsuperscript{53} [2009] EWHC 1441 (Ch).
\textsuperscript{54} Akers and McDonald v. Deutsche Bank AG (Re Chesterfield United Inc. and Partridge Management Group SA) [2012] EWHC 244 (Ch).
\textsuperscript{55} Larsen and others v. Navios International Inc (Re Atlas Bulk Shipping AS) [2011] EWHC (Ch) 878.
\textsuperscript{56} Cosco Bulk Carrier Co Ltd v. Armada Shipping SA and another [2011] EWHC 216 (Ch).
\textsuperscript{57} Re Stanford International Bank Ltd (in liquidation) [2010] EWCA Civ 137.
\textsuperscript{58} Re Agrokor DD [2017] EWHC 2791 (Ch).
\textsuperscript{59} Re OJSC International Bank of Azerbaijan [2018] EWHC 59 (Ch).
The CBIR provide that, on the recognition of a foreign proceeding, the court may order ‘the delivery of information concerning the debtor’s assets, affairs, rights, obligations or liabilities’, and may grant ‘any additional relief that may be available to a British insolvency office holder under the law of Great Britain, including any relief provided under Paragraph 43 of Schedule B1 to the Insolvency Act 1986’. In granting such relief, the court must be satisfied that ‘the interests of creditors . . . and other interested persons, if appropriate, including the debtor, are adequately protected’.

In a notable application of the CBIR, in Re OJSC International Bank of Azerbaijan, the foreign representative of Azerbaijan’s largest bank successfully obtained recognition by the English High Court of an Azerbaijani restructuring proceeding and was granted discretionary relief in the form of an administrative moratorium. The restructuring plan was subsequently approved by a substantial majority of creditors and by the Azerbaijan courts and, as the English High Court moratorium was due to expire upon the termination of the Azerbaijan restructuring proceeding, the bank applied to the English Court seeking an extension of the moratorium. The respondents, who did not vote or participate in the plan, objected to the application on the basis that their English law debt was not discharged by the Azerbaijani process because of the Gibbs rule. The respondents argued that they had not submitted to Azerbaijani law and, therefore, retained the right to enforce their claims in England, subject only to the moratorium still in place, which was due to expire. At first instance, the English court held that: (1) it did not have the power to extend a moratorium imposed under the CBIR without a limit as to time, and in particular, beyond the date on which the foreign proceeding terminated; and (2) it should not grant a further moratorium. Hildyard J stated that ‘the Model Law is designed to afford a breathing space only until that stage (of the plan taking effect according to the law by which it is governed). Though the ‘tool-box’ may be deep, the tools should not be deployed to subject a creditor whose rights cannot by the law of this jurisdiction be substantively changed under the law of the plan to restrictions beyond that limit in time.’ The English Court of Appeal agreed with the High Court and held that relief under the Model Law should be consistent with its procedural and supporting role and could not continue beyond the termination of the relevant foreign proceeding.

In the summer of 2018, however, UNCITRAL published a new Model Law on the Recognition and Enforcement of Insolvency-Related Judgments (the IRJ Model Law), which is now available for domestic adoption globally. Article 13 of the IRJ Model Law sets out a mandatory obligation to recognise and enforce foreign insolvency-related judgments and would, if the UK were to adopt the IRJ Model Law and the English courts to resolutely apply its effects, reverse the position enshrined in Rubin and the rule in Gibbs, and would represent a significant liberalisation of the English law approach towards recognising the substantive effect of foreign law insolvency procedures.

### iii Judicial assistance to proceedings commenced in another jurisdiction

Section 426 of the IA86 provides for the UK courts to give assistance upon request to the courts of other designated jurisdictions, which are mainly Commonwealth countries.

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60 Article 21(1)(d), Schedule 1 of the CBIR.
61 Article 21(1)(g), Schedule 1 of the CBIR.
62 Article 22(1), Schedule 1 of the CBIR.
63 [2018] EWHC 59 (Ch) at [33].
Where Section 426 applies, it provides an alternative means of relief and assistance to the Insolvency Regulation and the CBIR, and the UK courts can apply the insolvency law of either jurisdiction in relation to the assistance requested.

In the important case of *Rubin v. Eurofinance SA*, the Supreme Court confirmed that English courts have a common law power to recognise and grant assistance to foreign insolvency proceedings. On the question of enforcing foreign insolvency judgments, however, the Supreme Court held that the English courts will only enforce a foreign judgment against a party that was present in the foreign jurisdiction when the proceedings were commenced, or that made a claim or counterclaim in the foreign proceedings, or that appeared voluntarily in the foreign proceedings, or that otherwise agreed to submit to the foreign jurisdiction.

It was decided that the English courts and many Commonwealth courts applying English common law will enforce a foreign judgment in personam only if at least one of the conditions summarised in Dicey, Morris & Collins, *Conflict of Laws*, 15th ed., 2012 (Dicey), as Rule 43, is satisfied. One of those conditions is described in Dicey as follows:

*a court of a foreign country outside the UK has jurisdiction to give a judgment in personam capable of enforcement or recognition as against the person against whom it was given . . . if the person against whom the judgment was given had before the commencement of the proceedings agreed, in respect of the subject matter of the proceedings, to submit to the jurisdiction of the court or of the courts of that country.*

### iv Cross-border protocols

In an attempt to promote cooperation between international bankruptcy courts, the Judicial Insolvency Network (JIN) held its first meeting in October 2016, attended by judges from the US (Delaware and the Southern District of New York), Canada (Ontario), Australia (Federal Court and New South Wales), the British Virgin Islands, the Cayman Islands and England. Hong Kong sent an observer and the judiciaries of Bermuda, South Korea and Japan requested to be kept apprised of the discussions and the outcome. The meeting produced the Judicial Insolvency Network guidelines for judicial communication and cooperation on cross-border insolvency matters (the JIN Guidelines). The JIN Guidelines, which have been adopted by several important jurisdictions, encourage direct communication between courts and require the mutual recognition of statutory law, regulations and rules of court applicable to the proceedings in other jurisdictions without further proof. Further, a court must generally recognise that orders made in the other proceedings were duly made for the purposes of the proceedings without further proof.

Courts are permitted to communicate in advance of joint hearings to establish procedures for the making of submissions and the rendering of decisions and to resolve any

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64 [2012] UKSC 46.
65 Paragraph 14R-054.
66 Including the Supreme Court of Singapore (via Registrar’s Circular No. 1 of 2017), the US Bankruptcy Court for the District of Delaware (via Local Bankruptcy Rule 9029-2), the US Bankruptcy Court for the Southern District of New York (via General Order M-511), the Supreme Court of Bermuda (via Practice Direction, Circular No. 6 OF 2017) and the Eastern Caribbean Supreme Court for the British Virgin Islands (via Practice Direction 8 of the BVI’s Insolvency Rules 2005). The English High Court adopted the guidelines on 5 May 2017 by adding a reference to the JIN Guidelines in Chapter 25 of the Chancery Guide.
procedural, administrative or preparatory matters. During a joint hearing, each court retains sole and exclusive jurisdiction over its own proceedings but each court should be able to hear the other proceeding simultaneously. After the hearing, courts may communicate with or without counsel present, including on substantive matters. It is noted that, regardless of the legal framework, the scope for joint hearings between courts in different jurisdictions may be limited where the time zones, language or legal culture are significantly different.

VI FUTURE DEVELOPMENTS

i The impact of Brexit

As highlighted above, it is not possible at this stage to predict with any certainty the form of the long-term relationship that will exist between the UK and the EU in the future. However, it is suggested that the options range from European Economic Area (EEA) membership, which would put the UK in a similar position to that of Norway, to no trade agreement, which would place relations between the UK and the EU on a World Trade Organization (WTO) basis. It is possible that a unique arrangement will be reached that does not reflect any current precedents, but considering the possible position under these two extremes provides an indication of the issues that are likely to arise.

If ratified, the negotiated Withdrawal Agreement between the government would provide for the continuation of the current cross-border framework for a period of time; however, the arrangement following the expiry of the transitional period would be subject to further agreement between the UK and the EU. In the longer term, if the UK were to agree to retain EEA status, it would be open for the UK to seek to agree with the EU that the Recast Insolvency Regulation continue to apply to the UK, although this would be unprecedented as the Recast Insolvency Regulation does not currently apply to any non-EU member. The continuation of the Recast Insolvency Regulation would be essential for the automatic recognition of UK insolvency processes in the EU.

A no-deal Brexit may well make it harder for UK office holders to be recognised in EU Member States and to enable them to deal with assets located in those other member states. Much depends upon the private international rules in the particular Member State and practitioners will need to ascertain the relevant Member State’s approach. In Germany and the Netherlands, for example, there may well be recognition in cases where the UK process has followed and applied COMI rules in line with the Recast Insolvency Regulation. However, in cases where the appointment of a UK office holder has been made in reliance on a UK domestic approach rather than the COMI rules, it is much less certain that there will be recognition in the relevant Member State. Where Member States have passed laws based on the Model Law, this may help UK insolvency office holders seeking recognition, however, as at the time of writing, the only other EU Member States that have done so are Greece, Poland, Romania and Slovenia. In other key EU jurisdictions such as France, Italy and Spain, recognition will likely require a more lengthy judicial recognition process and there will be greater scope for parallel proceedings with the concomitant risks of increased costs to the insolvency estate and different treatment of creditors. The aforementioned countries have not indicated that they will be adopting the Model Law any time soon.67

67 It should also be noted, however, that Ireland will also be able to seek judicial assistance in the UK pursuant to Section 426 of the Insolvency Act 1986.
The position in relation to inward bound insolvency processes is unlikely to have the same element of uncertainty because of the CBIR. In a no-deal Brexit scenario, these regulations are likely to be heavily used by practitioners in EU Member States seeking recognition and other relief, including an automatic stay in many cases with a discretion to extend and seek further relief where possible.

The position of English schemes of arrangement, however, is more nuanced. Schemes, which are not an insolvency process but rather a function of company law under Part 26 of the Companies Act 2006, not subject to the Recast Insolvency Regulation meaning that their availability to foreign companies is not dependent upon whether the existing Recast Insolvency Regulation continues to apply in the UK or is largely removed from English insolvency law in the no-deal scenario. Similarly, as highlighted above, the hypothetical questions about whether the jurisdictional tests under the Recast Brussels Regulation apply to English schemes proposed by foreign companies would cease to apply in the no-deal scenario, leaving the ‘sufficient connection’ test as the only relevant test for the English court’s consideration as to whether to exercise its jurisdiction.

Nevertheless, as foreshadowed above, recognition of schemes of arrangement proposed by foreign companies (where their nexus to the UK is COMI) may be a more cumbersome process if the Recast Brussels Regulation is repealed, as the present practice of foreign companies adducing evidence that the scheme will be recognised in the relevant EU Member States in which the terms of the restructuring must be implemented (in order to satisfy the English court that its order sanctioning the scheme will not be in vain because the effects of the scheme will indeed be implementable) has relied on the above-mentioned articles of the Recast Brussels Regulation.

Going forward in a post-no-deal Brexit scenario, recognition and enforcement of schemes of arrangement in the EU would be a matter entirely for the private international laws of EU Member States. In most cases (for example, a scheme proposed by a foreign company which seeks to compromise debts governed by English law), it is likely that EU Member States would not have a problem with continuing to recognise and enforce the effect of schemes of arrangement in accordance with their own rules of private international law and without the added assistance of the Recast Brussels Regulation. However, a noteworthy exception would potentially be the recognition of schemes proposed by companies incorporated in EU Member States which have purported to establish sufficient connection with the English court’s jurisdiction by shifting their COMI into the UK. Such scheme proposals may be at greater risk of challenge unless there are other UK-connecting factors.

The UK government’s intention is that, in the absence of a deal with the EU, it will rejoin the Hague Convention on Choice of Court Agreements 2005 in its own right (rather than its current participation by virtue of its EU membership). To that end, the government took the step on 28 December 2018 of depositing its instrument of accession to contract to the Hague Convention in its own right.68 The continuation of the UK’s participation in the Hague Convention would mean that courts in EU Member States would be obliged to give effect to exclusive choice of court agreements designating the English courts entered into

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68 If the Withdrawal Agreement is concluded and enters into force on exit day, the UK will continue to be treated as an EU Member State during the transition period and EU law, including the Convention, will continue to apply to the UK for the duration of the transition period. In these circumstances the UK will withdraw the instrument of accession.
after that date, and to enforce the resulting judgments in accordance with the Convention.\textsuperscript{69} Although the steps taken to provide for the continued application of the Hague Convention are to be welcomed, there are certain limitations as compared to the current regime, including that the Hague Convention does not contain any rules relating to jurisdiction in situations other than exclusive choice of court agreements, and does not contain any rules relating to jurisdiction in the absence of party choice.

Any doubt on the possible recognition of schemes may lead to practitioners deciding to use the restructuring tools of other EU Member States where recognition is clear cut, particularly in light of the above-mentioned efforts by the EU to harmonise restructuring frameworks pursuant to the Directive on Preventative Restructuring Frameworks. It is anticipated, however, that the factors that make the UK an attractive forum for international restructurings, and the structural and cultural shortcomings that make many foreign companies, both within and beyond the EU, reluctant to pursue complex restructurings in their home jurisdictions, will continue regardless of the political events to come.

\section*{ii Corporate insolvency framework reforms}

The legislative timetable for the wide ranging proposals in relation to the reform of the UK restructuring and insolvency framework is not known at this stage, and instead the government has said the reforms would be introduced through legislation as soon as ‘parliamentary time permits’.

It is noted that, at the time of writing, no legislation has been proposed by the government in relation to the proposed reforms and it is unclear when this will occur. In February 2019, the City of London Law Society and the Insolvency Lawyers' Association published an issues paper in reply to the government’s 26 August 2018 response to the BEIS consultation, which raises a number of conceptual issues regarding the substance and operation of a number of the proposals that will need to be addressed, particularly the adaptability of certain features transported from equivalent provisions under Chapter 11 of the US Bankruptcy Code into the UK insolvency framework. As such, the current expectation is that a number of additional consultations alongside development of the details of certain measures will be required prior to any advancement towards legislative drafting and the parliamentary discussion phase.

\section*{iii Crown preference}

The UK Chancellor announced a proposal in the 2018 Budget to partially reinstate HMRC (the UK tax authority) as a preferential creditor in insolvencies from 6 April 2020 (commonly referred to as ‘Crown preference’). It is proposed that preferential status will only apply to taxes paid by employees and customers that a company collects on behalf of HMRC (e.g., VAT, PAYE, employees’ NIC and construction industry scheme deductions) and the status of income tax, capital gains tax, corporation tax and employer NICs will remain unchanged. Under this proposal, taxes subject to Crown preference would rank ahead of creditors with floating charge security and unsecured creditors. At the time of writing, the proposal remains under consultation and may not be enacted into law in its current form, or at all.

\textsuperscript{69} To that end, the Civil Jurisdiction and Judgments (Hague Convention on Choice of Court Agreements 2005) (EU Exit) Regulations 2018 (S.I. 2018/1124), which contain provisions required to implement the Hague Convention in the UK after the UK accedes to the Hague Convention in its own right, were laid before the British Parliament on 1 November 2018. These regulations will only come into effect on exit day in the event of a no-deal Brexit.
Chapter 6

FINLAND

Martina Kronström

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

The Finnish economy is expected to slow down substantially during 2019 after a slight upturn in recent years. The abating growth of the Finnish economy is predominantly a result of a decline in construction investments and a downturn in foreign trade. In 2019, GDP is expected to grow by 1.7 per cent and private consumption is expected to continue growing as a result of a higher employment rate. Private investments are expected to grow at a stable pace. The decline in world trade is expected to hinder Finnish export prospects over the following years. The combination of stagnant economic growth and a rise in nominal wages is likely to reduce the demand for labour force in the coming years.

During 2018, 2,534 bankruptcy proceedings were commenced, which is a 16.9 per cent increase compared to 2017. Owing to data system changes in the Finnish tax administration, the number of bankruptcies between January 2018 and March 2018 increased by 60.4 per cent compared to the corresponding period in 2017. Consequently, the Finnish tax administration, one of the main initiators of the bankruptcy proceedings, filed 339.8 per cent more bankruptcy petitions between January 2018 and March 2018 than in the corresponding period in 2017. Between January 2019 and April 2019 there were 6.5 per cent fewer bankruptcy petitions than in the corresponding period in 2018. These bankruptcy proceedings involved in all 4,196 employees, which is 11.4 per cent less than in the corresponding period in 2019. The overall rate of bankruptcies seems to have slightly increased.

In 2018, there were 4.5 per cent fewer restructuring proceedings commenced than in 2017. The number of employees affected by the restructuring proceedings was 28.6 per cent less than in 2018. Between January 2019 and March 2019, there were 101 applications for restructuring, which is 2.8 per cent less than in the corresponding period in 2018. The amount of restructuring proceedings has been in steady decline over the past years. Approximately two-thirds of restructuring proceedings end with a court-approved restructuring programme. However, restructuring proceedings are very often discontinued when the applicant becomes bankrupt.

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4 Statistics Finland, published 24 January 2018.
7 Statistics Finland, published 17 April 2019.
II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

Finnish legislation recognises two alternative overall insolvency proceedings for companies: bankruptcy and restructuring.\(^8\) Bankruptcy aims to divide the remaining assets of an insolvent company between its creditors. Restructuring aims to arrange the debts and to rehabilitate the viable business of the company in order to keep the business running.

There will be some changes in the bankruptcy legislation and the changes are expected to enter into force by 2020 at the latest. See Section III for more details.

i Bankruptcy proceedings

Bankruptcy proceedings are regulated in the Finnish Bankruptcy Act\(^9\) and begin with a district court’s order upon an application. The application may be filed by the debtor or by a creditor. In practice, a majority of bankruptcy proceedings commence by a petition of Finnish insurance companies or tax authorities.

The main prerequisite for a bankruptcy is that the company is insolvent, (i.e., other than temporarily unable to repay its debts as they fall due). When the debtor itself petitions for a bankruptcy, its own announcement of insolvency is generally sufficient. If the bankruptcy has been petitioned by a creditor, the district court must investigate the claimed insolvency in more detail. If the debtor contests the petition, the matter will be handled in the court as a non-contentious civil case.

Unless the debtor proves otherwise, the district court generally deems it insolvent if: (1) the debtor has discontinued its payments; (2) it has been determined in enforcement proceedings that the debtor cannot repay the claim in full; or (3) the debtor has not repaid the clear and due claim of the creditor within a week of the receipt of a reminder. In practice, debtors are deemed insolvent relatively easily. A debtor may not be declared bankrupt on the petition of a creditor if the creditor holds adequate collateral. Bankruptcy may be ordered reversed on the joint petition of the debtor and the creditor who filed the bankruptcy petition or, if the debtor has been declared bankrupt on his or her own petition, on the petition of the debtor. The application for reversal must be filed within eight days of the order of bankruptcy. There must be a valid reason for the reversal. Said valid reason is, in practice, usually that the receivables of the creditor who filed the bankruptcy petition have been paid.

At the beginning of a bankruptcy, a district court appoints an estate administrator. The estate administrator is usually an attorney-at-law that the creditors have suggested. When bankruptcy proceedings begin the debtor loses its authority over the company’s assets and the assets are transferred to the possession of the estate and are governed by an estate administrator. The creditors who have a claim in bankruptcy proceedings exercise their authority over the bankruptcy estate in the creditor’s meeting. The main rule is that the creditors must lodge their claims before a certain lodgement date in order to become creditors of the bankruptcy process.\(^10\)

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\(^8\) There are two other insolvency methods, the adjustment of the debts of a private individual and the general enforcement, but they are not presented here in more detail.


\(^10\) This will be the main rule in the new legislation but the estate administrator will be given a possibility to take debts into consideration without a lodgement made by the creditor.
A claim in bankruptcy proceedings means a debt is owed by the debtor and based on a commitment or other legal basis that has arisen before the beginning of bankruptcy. The debts that have arisen after the beginning of bankruptcy are not claims in the bankruptcy proceedings and the bankruptcy estate is obliged to pay them when they fall due. This means that a bankruptcy estate can also be declared bankrupt.

The purpose of a bankruptcy is to divide between the creditors as high a level of disbursement as possible. Secured debts have the primary right to disbursements. A bankruptcy ends either with the certification of the disbursement list and the payment of disbursements or with the collapse of proceedings. In practice, many small companies do not go through the whole liquidation process as the proceedings collapse because there are no funds to cover the costs of the proceedings. Usually the debtors are not willing to participate in funding the bankruptcy process. The upcoming changes in the bankruptcy legislation aim to relieve the estate administrator’s efforts in the beginning of bankruptcy proceedings so that the lack of sufficient funds is possible to detect at an earlier state. In some cases, the bankruptcy may continue as a public receivership, in which the costs of bankruptcy proceedings are paid from state funds in so far as the funds of the bankruptcy estate are insufficient to cover the costs of bankruptcy proceedings. Commencing the public receivership requires in practice adequate public interest to conduct the estate administration. This means a need to clarify the estate, for example, in order to be able to file a request for criminal investigation to police officials. The public receivership can also be commenced if the funds are not sufficient to cover the costs of the bankruptcy proceedings or if there are other significant reasons.

The estate administrator is obliged, within two months from the beginning of bankruptcy, to draft an estate inventory and a debtor description (the trustee’s clarification and observations of the debtor’s business and inter alia reasons that led to insolvency, as well as observations made by the trustee). In the new legislative framework, the estate inventory can be drafted in a lighter process consisting only of the debtor’s most significant commitments. As from 1 March 2013, the estate administrator is obliged to present the debtor description to the prosecutor, the debtor, the main creditors and, at request, also to other creditors and the pretrial investigation authority, namely, the police. Also as from 1 March 2013 the estate administrator is – with certain limitations – obliged to draft a request for investigation for police authorities if the estate administrator has any reason to suspect that the debtor has committed a crime.

ii Restructuring proceedings

Restructuring proceedings are regulated in the Finnish Restructuring of Enterprises Act. Restructuring proceedings include debt arrangements that are made in order to rehabilitate a distressed and insolvent company’s viable business and to ensure its continued viability.

Restructuring proceedings require that the company is insolvent or at least faces imminent insolvency, and that they should be initiated before the cash flow forces the company or its creditors to reconsider bankruptcy. Restructuring proceedings are fairly expensive and time consuming as it normally takes about a year before a possible restructuring programme is approved and the proceedings end. If the company’s assets are not sufficient to

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11 According to the new legislation, the estate administrator shall inform the debtors about the lack of sufficient funds within one month of drafting the estate inventory. This time limit aims to bring efficiency to the procedure.
cover the costs of the proceeding, the proceeding cannot be started. During the proceedings the company normally faces difficulties with suppliers, etc., owing to entries in the official records stating that the company is undergoing restructuring proceedings. These entries are indicators of insolvency and they tend to lead to suppliers, etc. requiring payment up front, which can be harsh on an insolvent company.

Restructuring proceedings cannot be started if the debtor is insolvent and it is probable that the restructuring programme will not remedy the insolvency or prevent its recurrence other than for a short period, nor can they be started if it is probable that the debtor will not be able to repay debts arising after the commencement of the proceedings. In addition, any debtor’s offences or other criminal actions by the company or anyone acting on its behalf, or material defects in the company’s books, will also form a barrier for restructuring proceedings.

The application for restructuring proceedings may be filed by the debtor, creditor, several creditors together or a probable creditor. Restructuring proceedings begin with a district court’s order upon an application, which normally is filed by the debtor company itself. When the restructuring proceedings begin, the court appoints an administrator. A court-appointed administrator, most often an attorney-at-law, will help the company to find different ways of rehabilitating the business.

The administrator shall prepare a report of the debtor’s assets, liabilities and other undertakings and regarding the circumstances that affect the financial position of the debtor and its expected development. The purpose of the report is to enable the creditors to assess the possibilities for an enforceable restructuring programme. The administrator monitors and supervises the debtor’s activities that are subject to the proceedings and sees to an audit of the debtor’s activities.

The administrator’s main task is to prepare a draft-restructuring programme together with the debtor and with the assistance of the creditors. The debtor and the creditors are also allowed to submit their own competing programmes to the court. It is common for the debtor to submit a competing programme but very rare for the creditors to do so. There are no regulations or case law on how a creditor-based programme should be dealt with together with the administrator’s programme. The restructuring programme shall specify the measures and arrangements designed to improve the debtor’s activities and the measures and arrangements that affect the status of the debtor and the creditors, as well as the reasons for the same. The programme should contain provisions on the debtor’s activities, whether they are to be continued or altered, the measures and arrangements relating to the assets of the debtor, such as allowing the debtor to retain assets, the liquidation or transfer of assets, the manner of liquidation or transfer, and the resulting or expected revenue from the same, arrangements regarding restructuring debts and the duty to make supplementary payments, arrangements regarding the personnel and remunerations to the debtor or an entity or person close to it for their services, and the financing and monitoring of the programme.

The restructuring programme must be approved by a majority of the creditors of the company. Therefore, if there is a justifiable reason to believe that the necessary conditions for the preparation or approval of a restructuring programme for the debtor do not exist, the application should not be approved in the first place or the proceedings should be interrupted.

One significant difference between restructuring and bankruptcy proceedings is that the commencement of restructuring has no effect on the debtor’s authority to dispose of its property and to decide on its activities. Some activities, such as taking on a new debt or the transfer of business require the consent of the court-appointed administrator.
The commencement of restructuring proceedings has no effect on the existing undertakings of the debtor, but the commencement of proceedings interrupts the accrual of overdue interest on restructuring debts. An interdiction of repayment of restructuring debts follows from the commencement of the proceedings. The restructuring debts can only be paid based on an approved restructuring programme or with the administrator's approval (e.g., small debts). After the commencement of the proceedings, no measures can be directed at the debtor in order to collect on a restructuring debt. This provides the debtor time to find ways to rehabilitate the business.

Debt arrangements cover only restructuring debts that have arisen before the filing of the restructuring application, and all debts arisen after the filing must be paid when falling due. Restructuring proceedings cannot be used to prevent a creditor from collecting his or her claim or otherwise to violate the rights of a creditor. There must, hence, be a genuine aim to rehabilitate the company.

The restructuring programme should contain and specify, for example, the measures and arrangements that are meant to improve the debtor’s business, the measures and arrangements that affect the status of the debtor and the creditors, as well as the reasons for the same. The programme must also contain a payment programme, which includes a schedule of payments of the restructuring debts. The payment programme includes information about the percentage to be cut from the debts. The average cutting percentage ought to be around 40 to 60 per cent. There are no provisions on how long the programme can be but the majority of programmes are between five to 10 years, only a small minority lasts less than two years or more than 10 years.13

When a restructuring programme has been approved by the district court, all entries are removed and the company can perform its business with only the restrictions that are mentioned in the programme. The programme itself is enforceable, so should the debtor not pay its restructuring debts in accordance with the programme or otherwise act as required in the programme, a creditor can file for bankruptcy.

iii Duties of directors of companies in financial difficulties

The Finnish Companies Act14 includes provisions concerning the liabilities of directors of companies in financial difficulties. Many of the provisions originate from the need to inform shareholders and debtors as well as authorities of possible difficulties. According to the Finnish Companies Act, the management of the company shall act with due care and promote the interests of the company. The requirement to act with due care is connected to the liability issues: the members of the board of directors or the supervisory board as well as the CEO are liable for the loss that they, in violation of the duty of care, or in violation of other provisions of the Companies Act or the articles of association of the company, have deliberately or negligently caused to the company.

The requirement to act with due care can be interpreted widely and thus it can be applied to various situations. The definition of due care shall be interpreted by comparing the actual actions taken to actions expected from a diligent person in an equivalent position. The concept of due care and the liability of the management has been specified through case law. It is typical that the liability issues are observed thoroughly in bankruptcy situations as

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it is in the interest of the bankruptcy estate as well as the creditors. The liability is mainly collective covering the board of directors as a whole and can actualise simply on the basis of participation in a specific board meeting.

When insolvency is forthcoming, the equity of the company often turns negative. This triggers the duty of the board to notify the Finnish Trade Register of the loss of the company’s share capital. Publicly listed companies are obliged to make a register notification when the equity of the company is less than half of the share capital. Neglecting the register notification is a violation of the Finnish Companies Act and may lead to personal liability of board members.

Finnish legislation does not include any obligation for a company to start insolvency proceedings. The board may, however, be considered to have caused the company damage if the board did not make a petition for insolvency proceedings in time. In Finland, the bankruptcy petitioner is often a creditor (i.e., the Tax Administration or an insurance company, not the company itself).

Publicly listed companies have an ongoing disclosure obligation according to the Securities Markets Act. In situations where the company is facing financial difficulties, the management of the company need to pay special attention to the obligation to disclose significant changes in the company’s financial situation.

iv Clawback actions
In Finland clawback actions are regulated in the Act on Recovery to a Bankruptcy Estate, and the Act is applicable to both bankruptcy and restructuring proceedings. Transactions made by the debtor prior to applying restructuring or bankruptcy proceedings may be subject to clawback if the transactions are harmful for the creditors.

The main and most commonly applied provisions are the general recovery provision (Section 5) and provision regarding the recovery of payment of a debt (Section 10). They are typically invoked together, but there are also cases that are based only on the general recovery provision.

According to Section 10, a payment of a debt carried out later than three months prior to applying the insolvency proceeding may be subject to clawback if the payment has been performed with unusual payment instruments or prematurely or with an amount that is considerable in relation to the assets of the debtor. An amount corresponding to around 10 per cent of the net assets of the estate is considered to be considerable. If the payment has been made to a person closely associated to the debtor, the time limit for clawback is two years. Clawback may be performed even if the transaction itself is valid and the creditor has acted in good faith.

The general recovery provision in Section 5 covers all kinds of transactions up to five years prior to applying of the insolvency proceedings. However, Section 5 is applicable only to inappropriate transactions that are made in order to evade the legal consequences of bankruptcy or restructuring. The prerequisite for applying this recovery provision is that the creditor has acted in bad faith.

In addition to the aforementioned clawback provisions, the Finnish Act on Recovery to a Bankruptcy Estate includes several specific provisions regarding for example, clawback of gifts, unreasonable benefits and collateral.

The clawback provisions are not applicable to customary transactions. Therefore, a transaction may not be recovered if it is, considering the specific circumstances of the case, an usual payment related to the ordinary business. In order to be subject to clawback, the transaction must be in deviation from previous practices and related to the future insolvency of the company.

A clawback claim may be made by a creditor or an administrator. A valid transaction made by the debtor is recovered, and the assets transferred in the transaction are returned to the bankrupt’s estate or, in restructuring proceedings, to the company. If the transferred assets do not exist anymore, the creditor must compensate the value of the assets. However, in restructuring proceedings, if the claim for clawback is carried on solely by a creditor (without the support of the administrator), the assets are transferred directly to the creditor.

Clawback claims are common in Finland, especially in bankruptcies, as clawback regulations may also be used to recover actions that without the insolvency proceedings would be considered valid. The threshold in the presentation of evidence is considered to be fairly low.

III SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

In March 2019, the Finnish parliament accepted a legislative package aimed at simplifying and digitising the bankruptcy and restructuring proceedings. The fundamentals of both proceedings will remain unaltered. The main changes have to do with shortening different time limits and streamlining the procedure to increase its effectiveness.

A bankruptcy estate’s liability for the waste caused by the bankrupt company as well as the relationship between the Bankruptcy Act and environmental legislation remain a hot topic. The aforementioned legislative proposal contained provisions aiming to clarify the opaque relationship of insolvency legislation and environmental protection. However, the proposed provisions were turned down by the Constitutional Law Committee. The question is thus still left open, but there is a wide unanimity on the urgency of resolving the legal uncertainties by way of legislative action.

Another hot topic is the possibility of using debt conversion as a means of restructuring. The following sections concerning future developments include our views on the possible forthcoming reforms.

In recent years there have been problems regarding cost-effectiveness in the retail trade sector. The increasing global trend of online shopping is likely to be one major reason. As a result, we have seen some large-scale bankruptcies and restructuring proceedings in this field. Two retail chains, the Hong Kong group of companies and Seppälä Oy entered into restructuring proceedings in 2017. The restructuring proceedings of the Hong Kong group were finalised in March 2018 and Seppälä Oy was declared bankrupt in September 2017.

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17 Accepted by Parliament on 11 March 2019. For the preparative parliamentary work on the proposal, see HE 221/2018 vp, YmVL 40/2018 vp, PeVL 69/2018 vp, LaVM 23/2018 vp.
18 PeVL 69/2018 vp. According to the Constitutional Committee, the proposed solution would have undermined the effective enforcement of environmental protection. The Committee urged for a more thorough preparatory work on the subject.
19 The restructuring proceedings of the Hong Kong group of companies covered 29 group companies altogether.
only five months into the restructuring proceedings. In the same vein, film rental group Makuuni Oy, with 20 business locations and 120 employees, was declared bankrupt in August 2018. The company had applied for restructuring over the preceding summer but the efforts to avoid bankruptcy proved futile.

Skala, a windows and doors manufacturing group, entered into restructuring proceedings in 2017 and the proceedings were finalised in 2018 when the District Court approved a seven-year restructuring programme. Late in 2018, another windows and doors manufacturer Domus Yhtiöt Oy was declared bankrupt. In March 2019, a Finnish-Estonian windows and doors manufacturer Fenestra Suomi Oy bought Domus Yhtiöt Oy’s window factory from the bankruptcy estate. Fenestra Suomi Oy is itself a successor of Fenestra Oy, a doors and windows manufacturer that was declared bankrupt in 2014. The bankruptcy of Domus Yhtiöt Oy is thus the third consecutive bankruptcy within the doors and windows manufacturing business, illustrating the over-capacity crisis and fierce price competition in the field.

A fairly new way of restructuring publicly listed companies is the conversion of receivables during the restructuring proceedings. The companies have either issued a convertible loan during the proceedings, the noteholders of which have the right to convert their receivables into shares, or issued new shares to their restructuring creditors. There are no regulations on how such a conversion of receivables should be enforced but it has been accepted by the courts. The Finnish government has initiated different studies to discuss whether a forced conversion could be added to the restructuring proceedings legislation. In 2017, the Ministry of Finance published a working group proposal strongly promoting the idea of adding forced conversion to restructuring legislation.20 In 2018, the Prime Minister’s Office published an international comparative study on debt-to-equity conversion in insolvency proceedings to provide background information for possible legislative action. The study does not contain any suggestions or proposals.21

IV RECENT AND FUTURE DEVELOPMENTS

As the legislative proposal concerning the environmental responsibilities of bankruptcy estates was turned down, it is expected that preparative work on the matter will continue in the near future. The question is contested and politically charged, making it difficult to foresee whether the work will lead to tangible results in the coming years.

As a result of the national implementation of the Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the New Insolvency Regulation), which entered into force on 26 June 2017, the Finnish insolvency registers have been expanded and made available to the public via the internet. The Finnish amendments came into force on 26 June 2018.

Another EU-based regulation that will lead to certain amendments to the national insolvency legislation is the Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase

the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (COM (2016) 723 final). The aim of the Directive is to create a harmonised European preventive restructuring framework to address problems and discrepancies with the existing national restructuring proceedings. The European Parliament adopted a resolution on the Directive in March 2019. Compared to the Commission Proposal, the Parliament resolution allows more room for national implementation and is thus is not likely to alter the fundamental components of the Finnish insolvency system. The time limit for national implementation ranges from two to seven years and the necessary implementation measures are likely to concern the Finnish Restructuring of Enterprises Act primarily. However, there has been some discussion about re-evaluating certain other insolvency proceedings as a whole when the preparatory work for implementing the Directive begins.

I  OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

With a GDP growth of 1.6 per cent in 2018 (compared to 2 per cent in 2017, 1.1 per cent in 2016, 1.2 per cent in 2015 and 0.2 per cent in 2014), restructuring and insolvency activity in France continued to slightly decrease, broadly speaking, in 2018 compared to previous years. Yet, with a total of 53,982 insolvency proceedings (safeguard, rehabilitation and liquidation proceedings, see Section II) opened in 2018 (down 1 per cent compared with 2017), this decrease is much lower than in 2017 (with a total number of insolvency proceedings down 5.8 per cent compared with 2016) and in 2016 (with total number of insolvency proceedings down 8 per cent compared with 2015). As in 2017, the bulk of these proceedings relate to very small enterprises as only 3,355 insolvency proceedings were opened for SMEs and bigger enterprises (representing only 6.2 per cent of the total number of insolvency proceedings), reflecting nonetheless a 1.57 per cent increase compared with 2017 and an 11 per cent increase compared with 2016.

In this context, the industries that have faced the most restructuring issues are the food and agricultural sector, the transport sector, the oil and gas sector, because of the continuing slump in energy and commodity prices, as well as the retail and tourism sectors (restaurants, carriers and hotels) because of sluggish household consumption, poor weather conditions, the geopolitical background (and, notably, the aftermath of the terror attacks of November 2015 and July 2016) and domestic social protests (in particular the ‘yellow vests’ protests).

As in previous years, restructuring and insolvency activity continued to witness a decrease of failing LBOs in 2018 (compared to the 2008–2010 and 2012–2014 rounds of restructuring). However, bankruptcy practitioners have continued to deal with a surge in sizeable and complex restructuring matters, including for listed companies.

In addition, 2018 saw the implementation of numerous total or partial sale plans in rehabilitation proceedings to transfer the business and assets of companies for which restructuring options were or proved impossible or that needed to scale down their operations (see Section IV). Turnaround funds have also been very active in this period and participated in most of these court-monitored auctions.

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1 Joanna Gumpelson and Philippe Dubois are partners at De Pardieu Brocas Maffei AARPI.
2 Based on statistics published by Banque de France.
II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

French bankruptcy law was extensively reformed in 2005 to promote reorganisation at a preventive stage and prompt creditors to take a more active role in pre-insolvency and insolvency proceedings, essentially through creating a safer environment for them to extend new credit facilities during both pre-insolvency and insolvency phases.

The major innovation was the creation of safeguard proceedings, which are intended to enable debtors that are in financial distress, but not yet insolvent, to reorganise and restructure under the court’s protection (essentially with a stay of enforcement actions, subject to very few exceptions) and negotiate a consensual restructuring plan with creditors. French bankruptcy law has been regularly amended since 2005 and an ordinance dated 12 March 2014 (the 2014 Ordinance) reformed bankruptcy laws, with a view to favouring reorganisation at a preventive stage, strengthening the efficiency of out-of-court proceedings and increasing the rights of creditors in insolvency proceedings. In addition, a bill dated 6 August 2015 (the 2015 Bill) introduced the possibility, under certain conditions, of squeezing out the shareholders of a bankrupt company in rehabilitation proceedings. Bankruptcy law was also slightly reformed in 2016 so as to improve certain technical provisions regarding insolvency proceedings and in 2017 in order to take into account the entry into force of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (Recast) that is applicable to insolvency proceedings to be commenced after 26 June 2017.

Two types of proceedings are available to distressed French companies (or foreign companies that have their centre of main interests (COMI) in France):

a) out-of-court proceedings: ad hoc proceedings and conciliation proceedings; and
b) court-monitored bankruptcy proceedings: safeguard (as well as pre-packaged safeguard proceedings), rehabilitation proceedings and liquidation proceedings.

The main provisions of each of these proceedings are set out below.

i Out-of-court proceedings

Ad hoc proceedings

Ad hoc proceedings are flexible, voluntary and confidential proceedings in which the president of the court appoints an agent to carry out appropriate tasks. In practice, these proceedings are used to organise informal negotiation between a company and its major creditors under the supervision of the court-agent.

Only the company’s legal representative can file a petition to the president of the court. It is usually considered that ad hoc proceedings are available to solvent companies only, but there have been some recent precedents where ad hoc proceedings were opened for insolvent companies (but for a very short period of time only). Major creditors are invited to consider debt rescheduling, cancellation and new money injection. In addition, the main shareholders can be invited to negotiate and potentially recapitalise the company. A debt-restructuring

3 Note that the French insolvency test is a pure cash-flow test (in contrast to a balance-sheet test) where a company is deemed insolvent when it is unable to meet its due debts out of its available assets (i.e., those in the form of cash or those that can be quickly turned into cash), taking into account undrawn committed facilities and other credit reserves and moratoriums or standstills accepted by creditors.
agreement accepted by some creditors cannot be imposed on other dissenting creditors, as the process is consensual and no cramdown can be imposed. In practice, majority rules provided for in the existing credit documentation (loan, bond, etc.) apply.

In addition, the opening of ad hoc proceedings does not trigger any automatic stay. However, the debtor can apply for a moratorium (for a maximum of two years) if any creditor attempts to enforce its rights while ad hoc proceedings are pending. Under the 2014 Ordinance, *ipso facto* provisions are now deemed null and void in ad hoc proceedings: creditors are, therefore, prohibited from accelerating a loan, or terminating an ongoing contract, by the sole reason of the opening of ad hoc proceedings (or of any filing for that purpose). More generally, any contractual provision increasing the debtor’s obligations (or reducing its rights) by that sole same reason is also null and void.

If an agreement is reached between a company and its creditors, the agent’s duties end. If there is no solution to the company’s financial difficulties and it later becomes insolvent then the only option is to initiate insolvency proceedings.

**Conciliation proceedings**

Conciliation proceedings are also flexible, voluntary and (to a certain extent) confidential proceedings that, under the supervision of a court-appointed agent, aim at facilitating negotiations between the company and its major creditors, and reaching a workout agreement that sets out the terms and conditions for the restructuring of the existing debt (waiver, rescheduling, etc.) and, if any, new loans extended by creditors or shareholders. Since the 2014 reform, the court-appointed agent may be entrusted with the mission to arrange a pre-packaged sale of a business in conciliation proceedings, the sale of which could ultimately be implemented in safeguard, rehabilitation or liquidation proceedings.

The debtor company must face legal, economic or financial difficulties (whether actual or foreseeable) so as to benefit from conciliation proceedings. Conciliation proceedings are available to solvent or insolvent companies provided they have been insolvent for less than 45 days before the petition is filed.

Conciliation proceedings are opened by the president of the court for a maximum period of four months, which can be extended to five months in total at the agent’s request. The management must cooperate with the court-appointed agent and the major creditors to negotiate a solution to the company’s difficulties. The court agent does not have any management responsibilities. There are no restrictions on business activities.

Trade creditors and major shareholders can also be invited to take part in the negotiations. Social and tax authorities can be asked to consent to a debt-rescheduling plan or a cancellation of debts. As in ad hoc proceedings, a restructuring workout accepted by some creditors cannot be imposed on other dissenting creditors in conciliation proceedings (subject to the opening of accelerated safeguard or accelerated financial safeguard). Majority rules provided for in the existing finance documentation will apply.

Even though the opening of conciliation does not trigger any automatic stay, the court can force any creditor that attempts to enforce its rights while conciliation is pending to accept a two-year maximum moratorium: in this case, the debtor’s petition is submitted to the judge who had jurisdiction to open such proceedings. As in ad hoc proceedings, creditors are prohibited from accelerating a loan, or terminating an ongoing contract, by the sole reason of the opening of ad hoc proceedings (or of any filing for that purpose). More generally, any contractual provision increasing the debtor’s obligations (or reducing its rights) by that sole same reason is also null and void.
When an agreement is reached between the debtor and its creditors, the parties have two options:

- a. the debtor can request a formal court approval of the workout agreement. This is to encourage creditors to extend new credit facilities. Indeed, new money facilities granted in the framework of a court-approved workout benefit from a statutory priority of payment should the company subsequently file for insolvency. Except where fraud has taken place, a court-approved workout agreement is also protected from the risk of being voided in the future. However, this court approval must be recorded in a full judgment accessible to the public and, therefore, subject to challenge by a third party or appeal; or

- b. the parties can obtain a simple acknowledgment from the president of the court. This option does not involve publicity, but implies that the creditors, having granted new money facilities in the framework of such conciliation proceedings, waive their right to priority of payment and, more generally, to protection against the risk of clawback in the future.

ii Court-monitored bankruptcy proceedings

Safeguard proceedings

Safeguard proceedings allow companies that, though still solvent, face difficulties that they cannot overcome, to be restructured at a preventive stage under the court’s supervision. Safeguard proceedings have three objectives in the following order of priority: (1) to allow the company’s business activities to be continued; (2) to preserve jobs; and (3) to repay creditors.

To open safeguard proceedings, the company must be solvent, but facing difficulties that cannot be overcome. In the Coeur Défense case, the Supreme Court held that no restriction should apply to the concept of ‘difficulty’ justifying the opening of a safeguard. In particular, to be granted the benefit of safeguard court protection, the debtor cannot be requested to characterise such difficulty as affecting its business activities. In that particular case, the Court ruled that the necessity for the debtor to renegotiate, in the case of an event of default, the terms and conditions of a loan may constitute a difficulty allowing such debtor to petition for safeguard proceedings. The 2016 reform specified that if it appears that the debtor’s difficulties could be overcome, the court must invite the debtor to request the opening of conciliation proceedings before ruling on the opening of safeguard proceedings.

If the company is insolvent or becomes insolvent after the opening of safeguard proceedings (that is, the company is unable to pay its due and payable liabilities arising post-filing), the court orders the proceedings to be converted into rehabilitation or liquidation proceedings.

Safeguard proceedings begin with an observation period of up to six months to assess the company’s financial position. This period can be extended once for six months, and in exceptional circumstances, can be further extended at the public prosecutor’s request for an additional six months. During this period, any decision that does not fall within the scope of day-to-day management must be approved by the bankruptcy judge. The bankruptcy judge must also approve any decision to settle pending disputes.

Once safeguard proceedings have been ordered by the court, there is an automatic stay of all creditor payment actions – subject to few exceptions (and notably claims secured by a security interest conferring a retention right, claims secured by a fiduciary agreement and set-off of related claims) – against the main debtor and individuals acting as guarantors and
joint debtors, but not against companies acting as guarantors or joint debtors. Hence the need, when group companies are acting as guarantors, to have all of them, as well as the main debtor, placed under court protection.

Interest for loans with a duration of one year or more, or for contracts having a deferred payment of one year or more, will continue to accrue but cannot be paid cash when due, and will be restructured as part of the safeguard plan.

The general outcome of safeguard is the approval by the court of a safeguard plan that can involve debt restructuring, recapitalisation of the company, debt-for-equity swap, sale of assets and a partial sale of the business. The safeguard plan cannot include a proposal to sell the business as a whole.

For companies of a certain size (that is, companies with more than 150 employees or with an annual turnover of more than €20 million), three classes of creditors (two committees and one bondholder group) must be set up (this is optional for smaller businesses subject to court approval):

a. financial institutions, comprising all banking institutions, financial creditors (investment or hedge funds, etc.) that have purchased bank debt or trade claims, or creditors that have lent money to the debtor by way of a loan (this may include shareholders that have granted shareholder loans);

b. major trade creditors (that is, trade creditors with more than 3 per cent of the total trade claims); and

c. bondholders (gathered into one single class, regardless of the currency or applicable law of the various bond indentures).

Each member of the creditor classes must inform the court-appointed administrator of the existence of any subordination agreement, agreement restricting or conditioning its vote and agreement allowing for third-party payment of the debt. The administrator must then submit a proposal for the computation of its voting rights to the relevant class member. If there is disagreement, the concerned class member can petition the president of the court through motion proceedings. To reinforce creditors’ role (so far reduced to making mere suggestions to the administrator), the 2014 Ordinance provides that any member of the committees (that is, financial institutions or major trade creditors, but not bondholders) can submit an alternative safeguard plan competing with the plan prepared by the debtor.

The plan is deemed approved by the classes if a two-thirds majority of the creditors (in value) in each class votes in favour of the plan. If the plan provides for a debt-equity swap (or any other operation requiring shareholder approval), shareholders must also be consulted and vote in favour of the plan at a two-thirds majority (no cramdown of shareholders is possible in safeguard). However, the majority applicable to shareholder meetings convened on first notice can be reduced by court order to a simple majority of the shareholders present or represented, provided they represent at least 50 per cent of the voting shares. Social and tax authorities are not members of the classes; they are invited to negotiate and can grant a debt rescheduling or cancellation.

If classes of creditors are not set up, or if one of the classes rejected the draft plan, the plan must be negotiated on a one-to-one basis with each creditor. If the creditors consulted individually refuse to approve the draft plan prepared by the company, the court can impose a 10-year maximum term-out to dissenting creditors. However, this 10-year maximum term-out is without prejudice to any longer maturity date agreed in the original loan agreement. Consenting creditors benefit from the shorter maturity date (if any) that they
would have negotiated. The court cannot impose any debt-to-equity swap or debt write-off of principal or interest claims in a term-out scenario. The yearly instalments under the term-out plan must not, after the third year following court approval of the plan, be less than 5 per cent of the total admitted pre-filing liabilities, except if the contract initially provides for a longer maturity date.

Once approved by the court, the safeguard plan is enforceable against all members of the creditors’ classes (financial institutions, trade creditors and bondholders), including the dissenting minority. However, French law does not allow interclass cramdown, as the court cannot impose a plan on a dissenting class of creditors when the class rejected the draft plan. However, this mechanism is very likely to be introduced soon (see Section VI).

Upon the approval of a safeguard plan, the court appoints an agent to supervise its implementation. If the company fails to meet its obligations under the plan and becomes insolvent, the court must order the plan to be cancelled and initiate rehabilitation proceedings or, if the rescue of the company appears obviously impossible, liquidation proceedings.

Pre-packaged safeguard proceedings

Two types of pre-packaged safeguard proceedings are available: accelerated financial safeguard and accelerated safeguard. Their global purpose is to implement a quick, simple process that allows the speedy reorganisation of a distressed company. Pre-packaged safeguard proceedings are opened at the debtor’s request provided the following eligibility criteria are satisfied:

- the company must meet certain thresholds (number of employees, minimum turnover or balance sheet test, consolidated accounts);
- conciliation proceedings must be pending (direct access to pre-packaged safeguard proceedings is strictly prohibited);
- the company must be solvent (from a cash flow standpoint) or, as the case may be, must have been insolvent for less than 45 days when it applied for conciliation; and
- the company must have prepared a draft plan in conciliation likely to receive sufficient support from its creditors.

The opening of accelerated financial safeguard proceedings only has effects in relation to financial creditors and, as the case may be, bondholders (therefore, excluding trade creditors from the process). Financial institutions and, as the case may be, bondholders, must approve the restructuring plan at a two-thirds majority in each class. The accelerated financial safeguard process must be completed within one month, renewable once for a maximum of one month.

In accelerated safeguard proceedings, all pre-filing creditors are included in the process (including trade creditors). The class of financial institutions, the class of major trade creditors (and as the case may be, the class of bondholders) are invited to vote on the plan proposed by the company at a two-thirds majority in each class. The accelerated safeguard process must be completed within a maximum of three months from the date of the opening judgment.

If creditors refuse to approve the pre-packaged plan, the court closes the proceeding and, if the company becomes insolvent, orders the opening of rehabilitation or liquidation proceedings.
Rehabilitation proceedings

Rehabilitation proceedings are the appropriate remedy if the company is insolvent (from a cash flow standpoint) but rescue does not appear to be impossible. Any company must file for rehabilitation (or, as the case may be, liquidation if there is no prospect for recovery) no later than 45 days from the date on which it becomes insolvent (provided that conciliation proceedings are not pending).

The objectives of rehabilitation proceedings are the same as for safeguard proceedings. Rules applicable to the observation period, the automatic stay and classes of creditors are also the same as in safeguard (with some exceptions, notably regarding shareholder consent).

In rehabilitation proceedings, the court-appointed administrator can simply assist the management to make decisions or can be appointed to take control of the company’s management in whole or in part. Any decision that does not fall within the scope of day-to-day management must be approved by the bankruptcy judge. The bankruptcy judge must also approve any decision to settle pending disputes.

There are two main possible outcomes for rehabilitation proceedings: a rehabilitation plan, where the same principles apply as in a safeguard proceedings; and a sale plan, where unlike in safeguard proceedings, should the debtor prove unable to present a sustainable restructuring plan (as the case may be a term-out plan), the court can authorise the administrator to auction the business as a whole or in part. Creditors (except for limited exceptions, e.g., creditors benefiting from a retention right) have no say on the choice of the purchaser, which is made by the court when approving the sale plan. No credit bid is allowed (there are some precedents, but in exceptional circumstances, e.g., pure SPV with no employees and only one creditor benefiting from a security interest over the quasi-sole asset).

The 2014 Ordinance introduced a limited possibility to have a court-appointed agent vote at shareholder meetings which was further amended in 2016: if the insolvent company’s net equity is not restored and the shareholders have refused to increase the company’s equity to at least half of its share value (which is a legal requirement in France), the administrator can petition the court to appoint an agent in charge of convening the shareholder meeting and to vote, on behalf on the dissenting shareholders, on the recapitalisation of the company for the amount suggested by the court-appointed administrator, when the draft plan provides for a change in the share capital in favour of one or several committed investors.

In addition, the 2015 Bill further introduced the possibility to squeeze out shareholders of a company under rehabilitation proceedings through a forced sale of all or part of the shares of the shareholders that have refused to implement the required change in the equity structure and that hold directly or indirectly a majority stake or a blocking minority stake in the capital of the company, or an imposed dilution of their equity stake. However, the application of this squeeze-out is limited to the following circumstances:

- the shareholders have refused to implement the change in the equity structure contemplated under the draft rehabilitation plan;
- the bankrupt company employs (directly or indirectly) 150 employees minimum;
- the disappearance of the company is likely to cause serious disturbance to the local economy and employment; and
- a share capital reorganisation is the only solution to allow business activities to continue (a partial or total sale of the company’s assets must be contemplated before allowing such squeeze-out).
**Liquidation proceedings**

Liquidation is the appropriate remedy when the company is insolvent and its rehabilitation appears to be impossible. The aim is to liquidate a company by selling its business, as a whole or by branch of activity, or by selling its assets one by one. Liquidation is the only possible outcome when a rehabilitation is attempted without success. Creditors are, as far as possible, repaid according to their rank and privilege out of the proceeds of the sale of the company’s business or assets.

Liquidation proceedings trigger an automatic stay of proceedings against the company. All pre-filing creditors are barred from enforcing their rights to seek payment from the debtor, subject to some exceptions (the same as those applicable in safeguard and in rehabilitation). In a liquidation (unlike a safeguard or in rehabilitation), secured creditors benefiting from a pledge can also enforce their security interest through a court-monitored allocation process, that is, request the court to be transferred ownership of the pledged assets.

Liquidation proceedings last until the liquidator finds that no more proceeds can be expected from the sale of the company’s business or assets. After two years (calculated from the judgment ordering liquidation), any creditor can request the court to order the liquidator to wind up liquidation proceedings.

There is a simplified form of liquidation proceedings available for small businesses, which lasts for a maximum of one year.

### iii Selected topics

**Directors’ liability**

Liability can arise in liquidation where, as a result of management errors (other than mere negligence), a company’s assets do not cover its debts: an action for mismanagement, which only applies in liquidation proceedings, can lead to an insolvent company’s management being liable for all or part of its debts. This liability can extend to formally appointed directors or managers with representation powers, and to any individual or entity that is not officially a director or manager but that has repeatedly influenced the company’s management or strategic decisions (that is, shadow (de facto) directors or managers).

A parent company can also be held liable for an insolvent subsidiary’s debts if it has been appointed as a director or is deemed a shadow director or manager of that subsidiary (e.g., through an individual appointed at the shareholders’ request).

The liquidator or the prosecutor can initiate the action. In addition, the majority of the supervising creditors (which would have been appointed by the court to assist the liquidator) can summon the liquidator to bring an action or commence proceedings on their own initiative if the liquidator does not do so after such summoning.

Directors found liable for certain specific breaches can be (independent of any liability action or criminal prosecution based on the same facts) forced to assign their equity interest in the company and prohibited from managing any business for up to 15 years, and holding any public office for up to five years.

Breaches include:

- using the company’s assets or credit for their own benefit, or the benefit of another corporate entity in which they have a direct or indirect interest;
- using the company to conduct and conceal business transactions for their own benefit;
- carrying out business activities at a loss to further their own interests, knowing that this would lead to the company’s insolvency;
d fraudulently embezzling or concealing all or part of the company’s assets; and

e fraudulently increasing the company’s debts.

**Clawback**

In rehabilitation or liquidation only (but not in safeguard proceedings), any transaction entered into during the hardening period (including transactions entered into with members of the same corporate family) can be subject to clawback provisions. The hardening period runs from the date when the company is deemed insolvent, and can be backdated by the court by up to 18 months before the insolvency judgment. If rehabilitation or liquidation proceedings are preceded by a pre-bankruptcy conciliation workout, the insolvency date cannot be backdated to a date before the court order approving the workout agreement.

The following transactions are automatically void (that is, the court must declare these transactions void on petition by the administrator, the liquidator or the public prosecutor) if performed during the hardening period:

*a* any deed entered into without consideration transferring title to movable or immovable property;

*b* any bilateral contract in which the debtor’s obligations significantly exceed those of the other party;

*c* any payment by whatever means, made for debts that have not fallen due on the date when payment is made;

*d* all payments for outstanding debts, if not made by cash settlement or wire transfers, remittance of negotiable instruments, or daily assignment of receivables or any other means commonly used in business transactions;

*e* deposits or consignments of money made under Article 2350 of the Civil Code (governing pledges over certain intangible assets, including claims) in the absence of a final judgment;

*f* any mortgage or pledge (both contractually agreed or court-ordered) granted to secure a pre-existing debt (in view of the reform currently under discussion, other types of security could be subject to voidance in the future, see Section VI);

*g* any protective measure, unless this measure gave rise to a recordation or registration before the date of insolvency;

*h* any granting, exercise or reselling of stock options made under Article L225-177 et seq. of the Commercial Code;

*i* any transfers of movables or assignment of rights into a trust estate, unless this transfer or assignment occurred as a guarantee of a debt concurrently undertaken;

*j* any amendment to a trust agreement affecting the rights and movables already assigned or transferred to a trust estate as a guarantee of debts undertaken prior to such amendment; and

*k* any declaration of non-seizability filed by the debtor, under Article L526-1 of the Commercial Code. A declaration of non-seizability can be cancelled if made during the six months preceding the insolvency date.

Any payment made or any transaction entered into during the hardening period is also subject to optional voidance (that is, subject to the court’s discretionary decision on petition by the administrator, the liquidator or the public prosecutor) if proper evidence is brought before the court that, at the time of the payment or transaction, the contracting party knew
about the company’s insolvency. When dealing with intra-group transactions, this knowledge is presumed for companies belonging to the same corporate group. Third-party rights, including bona fide third parties, can be affected by those voidance provisions.

III RECENT LEGAL DEVELOPMENTS

The 2014 Ordinance (applicable to pre-insolvency and insolvency proceedings since 1 July 2014) reformed French bankruptcy laws, with a view to favouring reorganisation at a preventive stage, strengthening the efficiency of out-of-court proceedings and increasing the rights of creditors in insolvency proceedings.

One of the main features of the 2014 reform was the introduction of pre-packaged sale plan, namely the possibility for the court-appointed agent to prepare a partial or total sale of the business in conciliation proceedings, the sale of which will ultimately be implemented in safeguard, rehabilitation or liquidation. The major purpose of such procedure is to shorten the period during which the company is under bankruptcy proceedings so as to preserve the value of the business transferred. The first pre-packaged sale plan was implemented in June 2015 when the business and assets of NextiraOne, a spin-off of Alcatel-Lucent, were transferred (alongside all of its 1,400 employees) to a purchaser only one month after the opening of rehabilitation proceedings. Later in 2015, the business and assets of Fram, a French tour operator, were also transferred through a pre-packaged sale plan.

The 2014 Ordinance also introduced a limited possibility to have a court-appointed agent vote at shareholder meetings if the insolvent company’s net equity is not restored. However, some practitioners considered that in this respect, the 2014 reform missed its initial purpose, which was to allow a squeeze-out of shareholders through forced sale of their shares or forced dilution of their equity stake. Even though the enforcement of a debt-equity swap against dissenting shareholders when the equity has lost all value and conversion of debt is the only solution to preserve the business as a going concern is viewed as essential by most practitioners, squeeze-out provisions were not adopted in 2014, as they could be assimilated into the creation of a new right to ‘expropriate’. This created constitutional law issues, which needed further review. The 2015 Bill sought to address this issue and provided for a limited squeeze-out of the shareholders in rehabilitation proceedings (see Section II). However, such squeeze-out remains untested to our knowledge.

In addition, the 2015 Bill also purported to enhance the restructuring of ‘large’ companies and group companies through the creation of specialised commercial courts having jurisdiction to supervise insolvency proceedings opened against companies of a certain size or that feature multi-jurisdictional aspects; the extension of the jurisdiction of the same commercial court to group’s subsidiaries or affiliates of a company under insolvency proceedings; and the obligation for the court, under certain conditions, to appoint at least two administrators and two creditors’ representatives.

Finally, the most recent legal development to be highlighted is the adoption of a bill dated 22 May 2019 which did not, per se, significantly reform French bankruptcy laws, but which empowered the French government to extensively modify, by way of ordinance, rules mainly pertaining to the vote on the draft safeguard or rehabilitation plan by classes of creditors as well as rules relating to security interests, especially in the context of restructuring and insolvency proceedings, paving the way for substantial reforms to be implemented in the coming years (see Section VI).
As described above, the most active sectors in 2018 were the retail, food and agricultural, oil and gas, automotive and tourism sectors. Although there has been a decrease in the number of insolvency proceedings in 2018, there were still quite a few active situations on the restructuring market with a surge in the number of sizeable and complex situations, many of them being listed companies.

The most significant French insolvency cases of 2017–2018 were the debt-equity swap of CGG (geophysics services) implemented through the combination of a safeguard plan in France and Chapter 11 proceedings in the US as well as the sale plan of Toys ‘R’ Us (as a consequence of the Chapter 11 proceedings commenced for the US entities).

With respect to out-of-court and pre-packaged proceedings, the major example of 2017–2018 was the restructuring of Bourbon (shipping services). In the retail sector, major restructurings had to be negotiated, such as for the French furniture retailer Conforama and fashion group IKKS.

France has not adopted legislation based on the UNCITRAL Model Law on Cross-Border Insolvency. The recognition and enforceability of insolvency proceedings commenced in another jurisdiction depends on whether such jurisdiction is party to a treaty with France. As such, Regulation (EC) 1346/2000 on insolvency proceedings (the Insolvency Regulation) allows insolvency procedures in different EU Member States to be automatically recognised. Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (Recast) reforming the Regulation 1346/2000 only applies to insolvency proceedings to be commenced after 26 June 2017.

If a company’s COMI is in France, the main proceedings can be commenced before the French courts under the Insolvency Regulation. A company’s COMI is presumed to be the place of its registered office unless it is proven that its COMI, as defined in the Eurofood decision of the European Court of Justice (case C-341/04, Eurofood IFSC Ltd), is in a country other than its place of incorporation, and that the company’s trade and financial partners are fully aware that the COMI of such company is not its place of incorporation.

Secondary proceedings can subsequently be commenced to liquidate an establishment’s assets located in another EU Member State. Secondary proceedings under the Insolvency Regulation are also appropriate if a company has an establishment in France, but its COMI is in another EU Member State.

In the Mansford case (Court of Appeals of Paris, 25 February 2010), several Luxembourg holding companies filed for safeguard in France on the grounds that their COMI was in France. In early 2010, the Paris Court of Appeals, applying the rationale of the Eurofood decision, held that French courts had jurisdiction over the matter for the following reasons:

- all management and other meetings were held either in Paris or locally where the real estate assets were located;
- the companies had no assets or activities other than a property asset and a letting activity in France (no Luxembourg activity whatsoever);
- the two holding companies’ sole purpose was to hold 100 per cent of their 10 subsidiaries (themselves carrying no activity in Luxembourg).
the ultimate parent company’s sole purpose was to own 100 per cent of holding companies that had no activity in Luxembourg; and

the relationship with the lenders was initiated in France and the renegotiation of the financing documentation took place in France.

If the Insolvency Regulation does not apply and insolvency judgments are made in a jurisdiction that does not have a treaty with France, they are not automatically recognised. Foreign judgments can only be enforced if they have been subject to an inter partes procedure known as exequatur, which is intended to verify that the foreign court had proper jurisdiction, international public policy has been complied with and no fraud has taken place. Such exequatur process usually takes a couple of months, excluding appeal, which could lengthen the process.

VI FUTURE DEVELOPMENTS

French bankruptcy law was reformed in 2014, 2015 and 2016 (see Section II). Initiated by the proposal for an European Directive published by the European Commission on 22 November 2016, prospective reform of French insolvency laws is expected to be soon implemented by way of an ordinance. Mainly relating to the voting process by classes of creditors on the draft safeguard or rehabilitation plan, this pending reform may provide for the set-up of more homogeneous classes of creditors and the possibility, under certain conditions that are still to be determined, to impose on dissenting classes a plan that was accepted by one class of creditors only, similar to what is provided for in the context of a US Chapter 11 proceeding.

French law relating to security interests is also expected to be amended in the coming years. Still under discussion, this reform is expected to simplify and clarify rules pertaining to security interests in the context of restructuring and insolvency proceedings.

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4 The final version of which is expected to be soon formally adopted and published in the Official Journal.
Chapter 8

GERMANY

Martin Tasma

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

Many experts believe that in 2019 we reached a turning point in the development of the German economy in recent years. While in 2017–2018 markets remained strong, and access to liquidity continued to be accommodative both for investment and non-investment grade companies, the landscape changed in the first half of 2019. Economic growth is cooling down and companies in various countries announced a reduction in their workforces.

Despite the availability of cheap funding as a consequence of the asset purchase programme of the European Central Bank (ECB) and its generally loose money policy in past years, the outlook for the German economy has recently deteriorated. International trade conflicts are slowing world trade, economic growth in many large economies, especially China, is decelerating, the political balance worldwide is in a state of flux and the uncertainties surrounding Brexit are creating concerns in Germany and among the customers of German industry, which is very export oriented. Even though the gross domestic product (GDP) in 2018 was overall 1.5 per cent higher than in the previous year and the German economy has thus grown for the ninth year in succession, growth has lost momentum. In the previous two years, the price-adjusted GDP had risen by 2.2 per cent in each case, but growth was somewhat lower than announced in January 2018. The economic situation in Germany was split in the year 2018: in the first half of 2018, GDP rose significantly but in the second half of 2018 GDP declined by 0.2 per cent in the third quarter and remained at the same level in the fourth quarter. However, according to first estimates, GDP again increased by 0.4 per cent between January and March 2019 compared to the previous quarter. Nevertheless, there is no reason to give the all-clear.

These developments have had a major impact on the German restructuring market. The number of newly opened insolvency proceedings dropped from 153,549 in 2010 to 104,287 in 2017 and decreased further to 98,409 in 2018. Compared to the 2017 figures,
this marks a 5.6 per cent decrease in overall newly opened insolvency proceedings. In 2018 the number of company insolvencies fell by 3.6 per cent compared to between 2017 (with a total of 19,552 in 2018). The 2018 figures mark a two-decade low in company insolvencies.4

However, in the current year of 2019, the phase of declining insolvency figures that has lasted since 2010 is likely to end and for the first time again more companies will go into insolvency according to industry experts’ predictions.5 Already in January 2019, German courts registered 1,700 corporate insolvencies. This was 5.7 per cent more than in January 2018. In February 2019, 1,579 corporate insolvencies were reported.6 Even though this was 2.8 per cent less than in February 2018,7 experts expect insolvency activities to pick up further in the rest of the year, in particular in the fourth quarter.

At the centre of new insolvency proceedings is currently one of Germany’s key industries – the automotive sector. The industry is facing the general problems of all economies of the European Union: worldwide trade conflicts and political uncertainties, the Brexit crisis and economic woes. But there are also industry-related problems. These include in particular the effects of the diesel crisis and the lack of a coherent and sustainable electric mobility strategy in many companies and countries. Car production rates in the second half of 2018 were 7.1 per cent lower than in the first half of the year.8 According to industry experts, the companies mostly affected of the changing conditions are less the manufacturers themselves but rather suppliers who are struggling with the developments. Suppliers are usually asked to pre-finance upcoming production orders, R&D and tooling to a large extent. This often leads to a stretched liquidity situation, which usually hits smaller suppliers hard. These developments will likely result in higher number of non-performing loans and distressed M&A transactions in the automotive sector, in particular with the aim to consolidate businesses with a focus on the production of parts for combustion vehicles.

Accordingly, the overall restructuring landscape shows a significant increase in financial corporate crises. The numbers are expected to increase even further over the course of the year reflecting expectations of an economic downturn. The prospects of a successful implementation of restructuring measures are also expected to decline which will most likely result in more insolvencies. In addition, the ability to finance restructuring measures is considered to be much more difficult than in previous years. It is expected that corporate loans will increasingly default in the wake of the negative economic situation.9

As regards the type of distressed transactions, the accommodative availability of liquidity, the continued growth of the German economy and the widely unchanged ECB monetary policy favoured mostly regular M&A transactions. However, international and national investors continue to show interest in German distressed debt and asset investments. In order to meet the various demands in a changing landscape, formal in-court insolvency proceedings were complemented by new mechanisms that led to a number of successful out-of-court restructurings and asset disposals from distressed companies as well as third-party driven trust structures.

4 Data derived from the German Federal Statistical Office website, available via www.destatis.de.
6 Data derived from the German Federal Statistical Office website, available via www.destatis.de.
7 Data derived from the German Federal Statistical Office website, available via www.destatis.de.
8 Data derived from the German Federal Statistical Office website, available via www.destatis.de.
The decreasing number of formal proceedings in the past already indicates that the German insolvency administration and advisory market was challenging in recent years. The business model of traditional insolvency administrators came under considerable pressure, and the German insolvency and restructuring landscape continued to follow a number of trends visible since the introduction of the Law for the Further Facilitation of the Restructuring of Companies in April 2012:

- Traditionally, German insolvency law and restructuring practice was focused on formal, court-driven proceedings. However, the focus has shifted more and more from traditional insolvency administration to pre-insolvency restructurings and self-administered processes; management officials tend to seek professional advice at an early stage and systematically explore options to negotiate consensual restructurings, often steered by chief restructuring officers (i.e., experienced restructuring experts).

- Restructurings of the passive side of the balance sheet are usually initiated by a debtor’s proposal for a consensual arrangement (e.g., by seeking to amend bond terms by a majority vote in accordance with the German Bond Act 2009), entertaining debt-to-equity swap concepts or proposing ‘amend and extend’ solutions; in case these negotiations fail debtors prepare ‘Plan B’ scenarios as a backup (i.e., will have developed strategies for a formal insolvency that often include the initiation of ‘self-administration’ proceedings with the debtor pushing for a restructuring as a going concern via insolvency plan (see Section II.ii)).

- Operational restructurings can be particularly onerous outside of formal insolvency proceedings as German insolvency law recognises a set of (e.g., labour- and contract-related) instruments that are not available in a pre-insolvency stage.

- Once the debtor – or a creditor – has filed for the opening of insolvency proceedings, the preliminary stage (often three months, see Section II.ii) of the proceeding is crucial for stakeholders, irrespective of whether the designated outcome of the insolvency is an asset sale to an investor, an insolvency plan restructuring, or a liquidation of the insolvency estate; deals are often fully negotiated at the preliminary stage and potential investors are generally well advised to approach the self-administrating management or the insolvency administrator as soon as possible.

Against this background, new European legislation and in particular the implementation of the Directive of the European Parliament and of the Council on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (the Directive on Preventive Restructuring Frameworks) has the potential to provide new features and may complement the existing mechanisms under German law effectively (see Section III).

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

Insolvency proceedings in Germany are initiated by a formal filing to the competent insolvency court. Under German law, the debtor and each of its creditors are entitled to file for insolvency by asserting that the debtor is illiquid or over-indebted. An insolvency in Germany is always governed by the provisions contained in the German Insolvency Code and
commencement of the proceedings is identical, irrespective of whether the parties involved seek a restructuring of the business or intend to have the assets liquidated and the sales proceeds distributed among the creditors.

i Duties of directors in a crisis situation

Directors of German companies are under a statutory obligation to file for insolvency without undue delay, but in no event later than after the expiry of three weeks, if the company is illiquid or over-indebted. The three-weeks period is only applicable, if there are restructuring efforts under way that may be expected to be successful. Otherwise, insolvency has to be filed immediately. These statutory duties may create considerable time pressure during negotiations over a consensual restructuring. Failure to file for insolvency in due time is a criminal offence and may result in personal liability of the managing directors to the creditors of the company.

Illiquidity

Generally speaking, a company is illiquid\textsuperscript{10} if it is unable to meet its payment obligations as they become due. If the company actually ceases to make payments, illiquidity is presumed. Under certain circumstances, a company that is unable to discharge its due obligations out of available cash might still be considered liquid if it can be expected to be able to discharge its liabilities (including any liabilities becoming due in this period) during the following three-week period.

According to the German Federal Court of Justice, illiquidity occurs if the debtor is unable to meet at least 90 per cent of its liabilities that are due or will become due within the following three weeks, unless (1) it can almost certainly be expected that the liquidity gap will be completely or almost completely eliminated in the near future and (2) delayed satisfaction of the relevant claims is acceptable based on the specific circumstances in each individual case. If the debtor’s liquidity gap is less than 10 per cent of its total due liabilities, illiquidity does not occur, unless it is already foreseeable that the liquidity gap will increase to 10 per or more cent in the near future.

Over-indebtedness

Two concepts are relevant in this regard.

Technical over-indebtedness

In principle, an insolvency filing obligation arises if the liabilities of the company exceed the value of its assets. Technical over-indebtedness is tested by drawing up an over-indebtedness balance sheet that does not follow normal accounting principles but special insolvency law accounting rules. The over-indebtedness balance sheet would, in particular, need to be based on liquidation values (i.e., showing hidden reserves and taking into account potential distressed sales discounts) and include the costs of liquidation.

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\textsuperscript{10} German insolvency law recognises an additional reason for the director to file for insolvency: imminent illiquidity. However, imminent illiquidity is not a mandatory reason for the director to initiate insolvency proceedings and practical importance is low.


**Continuation outlook**

Even in the event that the company is technically over-indebted, there is no obligation to file for insolvency, if the company has a positive continuation prognosis. Pursuant to a widely held view in legal literature, this criterion requires that the liquidity of the company is sufficient to ensure that the company will be able to pay its debts becoming due within the current and the subsequent financial year. This means that, effectively, the company is legally not considered over-indebted if continuation of the business, based on a reasonable and careful assessment, is more likely than not, regardless of whether technical over-indebtedness exists. The assessment as to whether the continuation of the business is more likely than not, must be based on: (1) a realistic business plan; (2) a corresponding and realistic cash-planning corresponding to such business plan; and, resulting therefrom; (3) an analysis that the business plan and the cash planning provide sufficient confidence that the company will be able to continue operations for at least the current and the next business year. In larger restructurings, a positive going concern prognosis is very often confirmed by an expert opinion that is prepared in accordance with the IDW S 6 standard issued by the German Institute of Auditors.

If challenged, the directors of the company bear the burden of proof. The statutory duties in fact require directors to take all necessary steps to put themselves in the position to timely recognise the occurrence of any insolvency trigger.

**ii Overview of German insolvency law**

German insolvency proceedings can be split into two phases, first the preliminary insolvency proceedings and second the main insolvency proceedings.

**Preliminary insolvency proceedings**

Preliminary insolvency proceedings serve the purpose of assessing whether main proceedings can be opened while at the same time preventing detrimental changes in the insolvency estate. To protect the estate of the insolvent company, the insolvency court normally appoints a preliminary insolvency administrator immediately. The main tasks of a preliminary insolvency administrator are to (1) secure and preserve the debtor's estate; (2) continue the business operations until the insolvency court decides on the opening of main insolvency proceedings; and (3) verify if the insolvency estate covers the costs of the proceedings.

The duration of insolvency proceedings depends on individual factors, such as the size of the relevant insolvency estate, the number of creditors, the complexity of the envisaged restructuring and the state of the company's bookkeeping. In practice, preliminary proceedings often last for approximately three months because under certain conditions, the Federal Labour Office bears the salaries of the debtor's employees for the three months preceding the opening of main insolvency proceedings. The payment of the salaries of the debtor's employees is a significant incentive for (preliminary) insolvency administrators to keep preliminary insolvency proceedings open for the period of three months as this means a considerable positive cash effect for the insolvency estate. In fact, the subsidy can be key for the continuation of the debtor's business in insolvency. It is established practice in Germany that banks pre-finance the salaries of the debtor's employees to ensure that the debtor's employees are paid regularly in the preliminary insolvency stage.

The German Insolvency Act does not explicitly provide for a moratorium as part of the preliminary proceeding. However, the insolvency court can order a variety of 'provisional measures'. These measures can be ordered jointly with the court's opening decision or separately at a later stage. In particular, the insolvency court may order that (1) a preliminary
insolvency administrator is appointed, (2) assets that would be subject to a right of segregation or for which separate satisfaction must not be used or collected by the creditors and (3) that the assets may be used to continue the enterprise insofar as they are of considerable significance for the insolvency estate. The insolvency court can also order that claims cannot be individually enforced against the debtor. These measures aim to keep the insolvency estate together to enable the insolvency administrator to pursue a structured sale of the business as a going concern or implement other restructuring measures.

If at any time during preliminary insolvency the preliminary insolvency administrator concludes that the company is in fact not insolvent or that the insolvency estate does not cover the costs of the proceedings, the insolvency court will terminate insolvency proceedings. In this case, creditors are free to enforce claims individually.

**Main insolvency proceedings**

Main insolvency proceedings serve the purpose of (1) winding down the insolvency estate by disposing of the debtor’s assets (including a disposal of the entire business or parts thereof as a going concern) and distributing the proceeds to the creditors in accordance with the applicable priority provisions, or (2) restructuring the company by implementation of an insolvency plan to be approved by the creditors by majority vote in groups (see Section II.ii).

Once insolvency proceedings are opened, the insolvency court will appoint a regular (non-preliminary) insolvency administrator. Upon opening of main insolvency proceedings, the power to dispose of and administer the insolvency estate shifts to the insolvency administrator. The insolvency administrator is under an obligation to act in the best interests of the creditors. He or she is not responsible towards the shareholders of the insolvent company and will attempt to dispose of or restructure the debtor’s business with a view to maximise the distributable proceeds. Notably, the insolvency administrator’s remuneration is in general calculated on the basis of the insolvency estate recovered for the creditors.

While the enforcement of security rights by individual creditors in the preliminary stage depends on whether the insolvency court has ordered interim measures in favour of the debtor, no individual enforcement of the rights of unsecured creditors is possible once main proceedings are opened and the realisation of security is widely restricted. The insolvency administrator will, as part of his or her standard exercise, also check whether security rights can be contested and are thus voidable. In particular, security that was granted within the last three months preceding the insolvency filing bears a significant risk of being contested once main proceedings are opened.

In large-scale insolvencies, a (preliminary) insolvency administrator will usually: (1) first seek contact with the debtor’s main stakeholders (including creditors, unions and shareholders, if any anchor shareholder is identifiable); and (2) initiate a structured sales process to give as many bidders as possible the opportunity to examine the business and submit offers for the whole business or parts thereof. This process will in most cases already have been initiated at the stage of preliminary insolvency proceedings. Often a deal is already negotiated at the time main proceedings are opened or even signed subject to the conditions that: (1) the main proceedings are opened; (2) the creditors’ committee or the creditor assembly, as the case may be, approves the deal; and (3) the preliminary insolvency administrator is appointed as insolvency administrator. If the debtor’s management has already been in (advanced) negotiations with a bidder prior to insolvency, the administrator will often be inclined to treat such bidder as preferred partner. However, a structured M&A process will comfort the insolvency administrator’s position as the outcome will demonstrate that she or he ultimately entered into a reasonable deal.
Creditors’ influence on insolvency proceedings

In insolvency, the insolvency estate is factually ‘owned’ by the creditors. Correspondingly, insolvency proceedings are mainly controlled by creditors rather than by the management or the shareholders. The creditors assert influence via the creditors’ assembly and the (preliminary) creditors’ committee.

Preliminary creditors’ committee

The institution of a preliminary creditors’ committee is mandatory if the debtor meets certain criteria in relation to his balance sheet total, gross turnover and number of employees. The insolvency court is responsible for appointing the members and instituting the committee. In a reasonably prepared insolvency, the debtor will already have reached an agreement with the main stakeholders that they will send representatives into the preliminary creditors’ committee. The court will then be in a position to institute the committee at the very beginning of the proceedings.

The (final) creditors’ committee shall consist of representatives of: (1) the secured creditors; (2) the insolvency creditors with the highest claims; (3) creditors with small claims; and (4) the employees. The composition rules are also practised for the preliminary committee. A ‘typical’ result of the institution process would, thus, be a committee with five or seven members, representing banks, the employees, the pension protection fund, smaller (trade) creditors, factoring companies and commercial credit insurance providers. Shareholders of the insolvent company who are personally liable cannot be members of the (preliminary) creditors’ committee.

The preliminary creditors’ committee’s most important power is its ability to influence the selection of the (preliminary) insolvency administrator. A unanimous vote of the committee in favour of a candidate overrules a deviating court decision, provided the person elected by the committee is eligible, independent and neutral.

Creditors’ committee

After main proceedings are opened and prior to the first creditors’ assembly, the insolvency court may institute a creditors’ committee. The members of the creditors’ committee are then elected by the creditors’ assembly. The committee’s main task is to assist and to supervise the insolvency administrator. Certain fundamental decisions, such as the disposal of the business (or parts of it) require the prior consent of the creditors’ committee and the committee is involved in all material decisions relating to the insolvency proceedings.

Creditors’ assembly

The main creditors’ representative body of German insolvency proceedings is the creditors’ assembly that can set up the creditors’ committee or revoke any court-appointed creditors’ committee. Core decisions regarding the insolvency proceedings, such as the decision whether to liquidate the insolvent company or to temporarily continue the business operations of the insolvent company, are taken by the creditors’ assembly. If no creditors’ committee is appointed, certain fundamental decisions require the prior consent of the creditors’ assembly. The sale of the business operations to a shareholder of the insolvent company requires the prior approval of the creditors’ assembly in any event. Decisions of the creditors’ assembly are taken by simple majority according to outstanding amounts. Subordinated creditors and creditors entitled to segregation do not have any voting rights in the creditors’ assembly.
**Self-administration proceedings**

Large corporates have in recent years often filed for insolvency in the form of ‘self-administration’, which is a special type of formal insolvency proceeding similar to US debtor-in-possession proceedings. If the management applies for the initiation of self-administration and the insolvency court follows that route, the court will order that the management of the debtor stays in charge of the operations of the company, to the effect that the restructuring or the liquidation of the debtor is not implemented by an insolvency administrator but (as the case may be) by the management itself. Self-administration may only be ordered if it is not expected that self-administration could work to the detriment of the creditors.

Self-administration is often considered to be an effective tool in a situation where insolvency is not a result of the failure of the current management but rather because of external circumstances or failure of the previous management. In this situation, it is often preferable to make use of management’s skills and company-related expertise and to have management implement a restructuring (or liquidation via asset deal) rather than bringing in an insolvency administrator who would have to start from scratch.

The management in self-administration will be supervised by a court-appointed (preliminary) custodian who needs to approve material transactions and reports to the insolvency court. Self-administration requires a skilled management, and the initial filing requires thorough preparation. Often, an insolvency in self-administration is being prepared as a plan B to back up negotiations with creditors on a consensual restructuring of debt. That way, the management preserves its options, should out-of-court negotiations fail. These processes are often steered by a CRO who was hired specifically for that purpose. Self-administration can – and very often is – combined with insolvency plan proceedings, in which case management would not only prepare and develop the insolvency plan, but also implement the plan once approved by the creditors.

**Insolvency plan proceedings**

Insolvency plan proceedings are an instrument to restructure or liquidate (e.g., via an asset deal) the insolvent company while derogating from the rules for the regular insolvency proceedings.

The preparation of an insolvency plan may be initiated by the debtor’s management or by the insolvency administrator; the latter either on her or his own initiative or upon request of the creditors’ committee. Insolvency plans are, at least in large-scale insolvencies, tailored individually. The underlying concept is that creditors are often better off if the business of the insolvent company is continued. In addition, the insolvency plan procedure allows the implementation of corporate measures that could not be used otherwise. A restructuring and sale of the businesses via insolvency plan may be particularly favourable if the value of the insolvent company consists of non-transferable intangible (IP) rights, concessions, licences, patents, favourable contracts or other assets that are not transferable in the course of an asset deal transaction without third-party consent. Other aspects that call for a restructuring of the debtor may be an intact stock exchange listing, the debtor’s position as group parent with non-insolvent subsidiaries and a specific tax position. Often, insolvency plans are used to restructure the insolvent legal entity (in contrast to a liquidation of its assets and a subsequent winding down of the entity) including by implementing haircuts, operational restructurings.

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11 Change of control clauses do not apply if contracts are transferred under a plan.
such as the termination of unfavourable contracts or a reduction of the personnel under insolvency rules. The restructured entity can then be sold and transferred to an investor who, as consideration, injects fresh money into the entity and pays a purchase price into the insolvency estate. The transfer will then be an integral part of the insolvency plan and will become effective upon court confirmation.

The German Insolvency Code allows the inclusion of shareholders into the plan and explicitly provides that: (1) the constructive part of the plan may set forth that creditors’ claims may be converted into share rights or membership rights in the debtor with the creditor's consent (debt-to-equity swap); and (2) the plan may foresee a decrease or increase in capital, the provision of contributions in kind, the ruling out of subscription rights, or the payment of compensation to outgoing shareholders. In essence, an insolvency plan may set out any rule permissible under corporate law. Procedural requirements and approvals that would apply under relevant corporate law for the implementation of any such corporate measure are suspended and substituted by the rules on voting and adoption of the insolvency plan. This involves that corporate law minority rights are widely suspended. Dissenting shareholders have little to no option to challenge a restructuring via insolvency plan other than by means of the limited remedies provided in the German Insolvency Code.

However, an insolvency plan can also provide that the debtor is liquidated by selling off business units as a whole by means of one or more asset deals, while winding down the remaining businesses by terminating unfavourable contracts with customers or suppliers, or both, and reducing staff. Finally, an insolvency plan may also be used to modify the proceedings as such without containing any substantive provisions or regulating the winding down.

An insolvency plan needs to be adopted with a majority vote of the creditors. An insolvency plan is voted on within creditor groups as provided for in the insolvency plan and within the statutory rules governing the composition of such groups. An insolvency plan is accepted if: (1) within each group a simple majority of the voting creditors – in number and according to outstanding amounts – consents; and (2) all groups consent. To prevent obstructive behaviour of individual creditors, the consent of a group of creditors is, simplified, deemed to have been granted if: (1) the members of the respective voting group are not worse off under the insolvency plan compared to the prospective outcome of regular insolvency proceedings; and (2) the majority of groups has consented the plan (so-called cram-down). Minority creditors are protected since creditors that have been overruled need to be better off under the insolvency plan than in regular proceedings.

Protective shield proceedings

In 2012, the German legislator introduced a modified preliminary self-administration proceeding by implementing the Schutzschirmverfahren. It neither constitutes an own type of insolvency proceeding nor a mechanism to restructure a company outside of insolvency proceedings (no pre-insolvency restructuring mechanism). Instead, protective shield proceedings are designed to buy a debtor that is not cash-illiquid time in order to prepare an insolvency plan under self-administration without running the risk of being liable for delaying.

The structuring of reorganisations via an insolvency plan is complex and requires corporate, insolvency and tax expertise, in particular since DES/haircuts generally create taxable restructuring gains on part of the debtor that may qualify as mass debt and which may impede the entire restructuring.
insolvency. While the protective shield mechanism was first used to prepare pre-packed deals by means of an insolvency plan while avoiding liability risks on the part of the managing directors, the use of protective shield proceedings has declined over the last years.

In parallel to the application for self-administration, the company can apply for protective shield proceedings, upon which the insolvency court grants, under certain conditions, a 'protection period' of up to three months during which management can prepare an insolvency plan. During protective shield proceedings, there is a ban on individual enforcement. Main proceedings are being opened at the earlier of the lapse of the protection period and the time on which the debtors hand the insolvency plan to the insolvency court.

**Clawback risks**

Clawback rights are substantial under German law and are subject to constant debate in Germany, with numerous disputed aspects and sometimes incoherent high court decisions. Despite recent reforms to cut back perceived excess clawback rights, the clawback regime still produces harsh results and is not always intuitive from a creditor’s perspective. Restructuring activities are not per se privileged in Germany, and fees paid for advisory services with respect to a failed restructuring may, therefore, be subject to clawback. In practice, insolvency administrators often raise clawback claims to open a forum for discussions on a settlement. In the end, those confronted with potential clawback claims will often agree to make settlement payments to avoid lengthy court disputes with an uncertain outcome.

Under German law, both legal and factual transactions can be challenged. The term 'transaction' encompasses all actions causing legal effects that may decrease the value of the debtor's assets to the detriment of insolvency creditors. A detrimental effect is determined objectively and requires that the relevant transaction has prevented, endangered, hampered, impeded or delayed the satisfaction of insolvency creditors as a whole. Detrimental effects are caused by a reduction of the debtor’s assets as well as by an increase of its liabilities. According to the prevailing view in German legal literature, even a sale of assets for a fair market value consideration can be deemed to be detrimental to the creditors of the debtor if the proceeds are no longer available at the time of insolvency (indirect detriment). The entering into, amendment, cancellation or assignment of contracts or contractual obligations as well as the detrimental effects of asset transfers and other *in rem* transactions are the most typical transactions to be challenged under German law. Upon successful enforcement of a clawback claim, the other party is obliged to return the assets to the insolvency estate or, if such return is not possible, compensate the insolvency estate in cash.

**Important clawback rights**

Detrimental transactions by a debtor with a third party are voidable if made during the last three months preceding the filing for opening insolvency proceedings and at a time when the debtor had been illiquid (i.e., unable to pay its debt) while such third party was aware thereof. Knowledge of the financial stress situation by the third party is likely to be assumed following, for example, due diligence exercises, communication during negotiations or other inside information obtained in business relations.

Detrimental transactions implemented up to ten years prior to the filing for insolvency may be challenged if the debtor acted with the intent to harm other creditors and the other party was aware thereof at the time of the action. The standard of intent is rather low and is easily fulfilled according to the courts. It is in particular presumed if the purchaser had knowledge that seller's illiquidity was more likely than not (>50 per cent) within the...
Germany

current or the subsequent financial year (referred to as ‘imminent illiquidity’). Generally, courts readily assume intentional actions by both the debtor and the respective third party, in particular if the third party is aware of a financial distress situation. As a rule of thumb, a debtor is deemed to have acted with the intent to harm other creditors if it is generally aware that the transaction at hand is to the detriment of other creditors (because it cannot reasonably trust that all current and future creditors will be satisfied) and continues to act despite this awareness. A debtor acts with the intent to harm other creditors if the company is illiquid at the time of the transaction. In addition, courts have developed a number of prima facie evidence norms that have indicative significance in a court procedure. Where the transfer of an assets or granting of collateral was legally owed by the insolvent party (e.g., under contract), an intent to harm the creditors will only be presumed by the courts if the other party had knowledge that at the time when the transaction was implemented the debtor was actually illiquid (rather than only imminently illiquid) and in such cases the relevant clawback period will only be four years (rather than ten years).

Informal restructuring instruments

In the German restructuring practice a number of informal (i.e., not court-governed) tools and strategies can be observed, particularly in large-scale and cross-border cases, which often require innovative approaches to overcome the deficiencies of statutory laws.

Parties are in principle free to negotiate amendments of loan agreements and other legal relationships at any time. Such settlements have legal effect only between the parties. From a debtor’s perspective, the main difficulty in initiating consensual restructuring discussions is that creditors are not obliged to contribute and neither are they prevented from enforcing their rights. In particular, small or secured creditors often have little incentive to agree on compromises. In order to be successful, a debtor will have to persuade main creditors to enter into a moratorium or stay agreement at an early stage of discussions. All parties involved may have to accept that hold-out creditors will ultimately be satisfied in full while others accept haircuts or make other concessions.

Restructurings in particular in the SME segment are sometimes implemented or governed by share trust structures, whereby creditors aim to shift control over the shares in the debtor from the previous owner to a professional trustee and a new management. Trustee and interim management will, subject to several conditions, exercise the shareholder rights and perform duties on behalf of the former legal owner and, at the same time, on behalf of the creditors. The underlying trust agreements usually define conditions under which the trustee is entitled or obliged, or both, to initiate a structured sales process for the company or specific businesses.

The terms of bonds (including secured bonds) that are subject to German law and for which the German Bond Act 2009 applies can be restructured by majority vote of the creditors, provided that the bond terms explicitly foresee the possibility for such modifications. In addition, the bondholders must approve material amendments in a bondholder meeting with 75 per cent of the votes cast. Today, most bonds issued under German law contain a clause that enables amendments of the terms by creditor majority resolution. It is also market-standard to appoint a common representative to streamline communication with the anonymous groups of bondholders in a situation of distress.
III RECENT LEGAL DEVELOPMENTS

In April 2017, the German legislator introduced amendments to the German Insolvency Code to limit clawback rights. The aim of the reform was to increase the predictability of clawback risks for (SME) companies doing business with financially distressed counterparts. In addition to the reduction of the clawback period from 10 years to four years in case of congruent coverage (see Section II.ii at Clawback risks), the amendments provided for a better protection of payments following a customary deferral of payment granted along the chain of suppliers and employee’s claims. The interpretation of clawback rules remains controversial, and it is doubtful whether the 2017 reform meant substantial progress for SMEs confronted with a distressed supplier or customer.

On 21 April 2018, the German Law for the Facilitation of Group Insolvencies came into force. New provisions were introduced to the German Insolvency Code, aiming to address procedural challenges that emerge under German insolvency law in relation to an insolvency of a German company that belongs to a group. In line with the approach taken on a European level for cross-border insolvency cases (Article 56 et seq. of EU Regulation 2015/848 on Insolvency Proceedings, which came into force on 26 June 2017), the fact that the insolvent company is part of a group does not open the gate to combined insolvency proceedings. Each company remains obliged to file for insolvency separately, and proceedings are strictly independent. However, the new provisions introduced rules governing the communication and coordination of and between insolvency administrators and insolvency courts. The law now specifically appreciates that the same person can be appointed as insolvency administrator for more than one group company and recognises the option to determine a comprehensive group venue, and in case of conflicting interest between group companies the appointment of an additional administrator to solve such situations. Consequently, the German Insolvency Code allows that a ‘group insolvency court’ steers group coordination proceedings and appoints an additional group coordinator (if required in case there is not one administrator for all entities) whose task is to develop a comprehensive group coordination plan. Creditor committees and insolvency courts are legally obliged to coordinate and exchange information.

However, the new Directive on Preventive Restructuring Frameworks (see Section I) will have by far the greatest influence on German legislation in the near future. The Directive was adopted by the European Parliament in March 2019 and by the Council on 6 June 2019. The Directive will enter into force in summer 2019, most likely in June or July. Member States will then have two years to implement the Directive in their national legislation. The Directive is being critically discussed among German insolvency and restructuring experts.

Practitioners and experts in the competent Federal Ministry of Justice are currently exploring how the instruments and procedures could be reconciled with domestic insolvency law and how the German legislator should best use the considerable discretion Member States ultimately have under the EU framework law. The expectation is that the implementation will have a considerable impact on German restructuring practice and will also require substantial domestic insolvency reforms (e.g., in relation to the German concepts of ‘imminent illiquidity’ and ‘over-indebtedness’ that are recognised reasons for a debtor to file for insolvency, creditor protection mechanisms and insolvency court powers). A number of market participants have expressed concerns that the Directive may create incentives for debtors to initiate inefficient and apparently unsuccessful restructurings and that the framework law would shift too much power from insolvency courts, insolvency administrators and creditors to ‘ruthless’ debtors and their advisers. Lately, concerns have mainly focused on the introduction of a
‘relative priority rule’ as opposed to an ‘absolute priority rule’ with respect to the adoption of a restructuring plan. Whether Germany uses its discretion for the implementation of the Directive to differentiate the new rules from the previous formal procedure and thus allow companies to effectively use the various possibilities of restructuring will also be crucial. However, it can be expected that the directive provides a supplementary element to a differentiated insolvency regime, which appears necessary in view of the above-mentioned requirements in the changing restructuring landscape.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

Despite the decrease in the number of insolvencies in 2017 and 2018, so far in 2019 there have been a number of large-scale insolvencies as well as prominent out-of-court restructuring activities.

The case still gaining a lot of media and restructuring experts’ attention is the insolvency of Germany-based airline Air Berlin in 2017. Following a preliminary self-administration, the businesses of Air Berlin were ultimately sold in pieces by Air Berlin’s German insolvency administrator and, as regards Air Berlin’s subsidiary NIKI, an Austrian insolvency receiver, in each case to competitors from the aviation industry. The Air Berlin insolvency was remarkable not only owing to its size and general importance for the functioning of the European transportation sector but also because the NIKI insolvency marked a prominent test for the interpretation of Article 3 EU Regulation 2015/848 on Insolvency Proceedings (definition of COMI in a group context).

At this stage, the insolvency of Air Berlin still triggers large repercussions. The insolvency administrator of Air Berlin sued Etihad Airways in December 2018. He believes that in April 2017, Etihad, as a major shareholder of Air Berlin, made a legally binding commitment in a so-called ‘hard letter of comfort’ to support Air Berlin financially for the next 18 months. The insolvency administrator demands at least €500 million in damages and the court has determined a preliminary total amount in dispute of €2 billion. Lately, Etihad has argued that the court in Berlin has no jurisdiction and that proceedings should be opened in London.

In February 2019 another German airline, Germania, filed for insolvency. The local court of Berlin (Charlottenburg) opened insolvency proceedings over the assets of the company after the business had been closed on 1 April. The assets will be realised and finally distributed to the creditors (i.e., restructuring efforts did not succeed). The insolvency of two airlines shows that the market is in a consolidation phase.

The same applies to the renewable energy sector. Companies affected in 2018 included Schletter, a Bavarian photovoltaic company that was eventually sold to an investment company. In 2019, the most attention so far has been paid to Senvion. Senvion is a leading manufacturer of wind turbines and operates worldwide. It filed for the opening of insolvency proceedings under self-administration for its German businesses at the local court of Hamburg in April. The situation is already affecting others in the industry – SSC Wind, which specialises in the construction and maintenance of wind turbines, recently filed for an opening of insolvency proceedings.

Moreover, as already discussed in Section I, the automotive supply industry is expected to change rapidly, potentially requiring financial and operational restructurings as suppliers...
face serious challenges with the diesel crisis and the lack of an electric mobility strategy in many companies. Questions of ownership and control over data will become crucial for suppliers’ systemic importance in the supply chain.

Other industries affected 2018 include the service sector (gfz services) and the consumer goods industry (Kettler, and in 2019 Loewe). The fashion industry is also still in a state of upheaval: In spring 2019 insolvency proceedings opened over the assets of Gerry Weber and retailer AWG filed for insolvency under self-administration proceedings in January. The insolvency proceedings over the assets of Paracelsus-Clinics, a major clinics operator, ended in 2018 with the sale of the company.

V INTERNATIONAL

For the past 20 years, German insolvency law was subject to constant reform and discussion. While the German government does not intend to implement further material insolvency law reforms soon, the coalition agreement of the present CDU/CSU and SPD government dated 7 February 2018 mentions a few projects to be implemented in the present legislative term. These are:

\begin{enumerate}[a]
\item the introduction of a professional law for the qualification and admission of insolvency administrators (and custodians) plus guidelines for professional standards of work;
\item concentration of insolvency courts (introduction of one-stop-shop elements) and digitisation of insolvency proceedings; and
\item increased insolvency protection of customers in property development projects.
\end{enumerate}

However, the next challenge to hit German insolvency law is the implementation of the European Directive on Preventive Restructuring Frameworks. The implementation of the Directive may force the German legislator to revise several domestic insolvency law concepts and rethink fundamental creditor protection instruments (see Sections I and III). In particular, it will turn out whether German insolvency law can withstand increasing European competition and whether Germany remains attractive as an insolvency location. The Europe-wide introduction of the Directive has the potential to further trigger competition among national legislation, and companies may increasingly resort to forum shopping. The individual implementation in the Member States will then decide which legal system is more preferable in each individual case.
Chapter 9

GREECE

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I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

i Liquidity and state of the financial markets

Actual GDP developments in 2018 and the outlook for 2019 indicate that the Greek economy is back on a track of positive growth. The challenge now is to preserve and reinforce the growth momentum so as to enable strong growth rates over a long period.

The reason for this is that growth has yet to gain sufficient traction, as reflected in a negative rate of change in investment, a negative household saving rate and a still high – albeit decreasing – rate of unemployment. The continued underexecution of the Public Investment Programme is also dampening growth.

The growth prospects for 2019 will, to a large extent, remain conditional on the course of the global economy and of the euro area economy in particular, as well as on the continuation of the reform effort.

In 2016 Greece made a significant economic adjustment, which was a result of extensive fiscal consolidation and implementation of reforms. In 2018, the GDP amounted to €190.8 billion, the gross public debt amounted to 181.1 per cent of its GDP and there was a surplus of 4.4 per cent. Growth was at 1.9 per cent, and is expected to reach 1.8 per cent in 2019. On the negative side, the enormous sacrifices and the internal devaluation had a strong impact on society, thus impairing poverty and unemployment rates, which reached 35.7 per cent and 19.3 per cent accordingly.

Key reforms include improving of fiscal figures, restoration of the banking sector’s growth, through reduction of non-performing loans and debt restructurings, introduction of collective dismissals, opening-up of closed professions and boosting of investment and privatisations. There is a debate between European institutions and the International Monetary Fund (IMF) as to whether the Greek debt is sustainable. On one hand, a majority of the European institutions claim that the debt is sustainable and there only needs to be some technical readjustments of the loan agreements. On the other hand, the IMF reiterates the need for a debt relief, which will be complemented with strong policy implementation in order to restore growth and sustainability. Nonetheless, European institutions are reluctant to proceed with a second debt haircut, partly because of the Treaty of the Functioning of the
European Union\(^3\) (no bailout clause) and partly because this would demonstrate a special and favourable handling of the Greek debt, in comparison with the handling of other Member States’ debts.

Moreover, the banking sector is on a close watch, as the three recapitalisations and the ongoing liquidity support from the European Central Bank and the Bank of Greece have not been enough to enforce their financial performance. Following issuance of a legal framework\(^4\) on the establishment and operation of credit servicing firms by the executive committee of the Bank of Greece, banks have become very active on taking measures to handle NPLs as well as NPEs, such as implementing internal procedures or outsourcing such services to third parties. Moreover, a good example of this would be the internationally innovative servicing agreement between the four systemic banks (Alpha Bank, National Bank of Greece, Eurobank and Piraeus Bank) on 31 July 2018 and a credit institution specialised in servicing non-performing loans, doBank S.p.A (doBank). This agreement is part of the strategic framework of the Greek systemic banks to reduce their non-performing exposure by protecting the viability of small and medium enterprises (SMEs) and supporting the recovery of the Greek economy. doBank will support the four systemic banks in the exclusive management of common non-performing exposures of more than 300 Greek SMEs with approximate nominal value of €1.8 billion, by facilitating the effective search of viable restructuring solutions when feasible. In the same context, foreign platforms managing NPLs such as Pillarstone, after signing a binding agreement with Alpha Bank and Eurobank in Greece, provides fresh long-term capital and operational expertise to large Greek corporate borrowers, helping them stabilise, recover and grow for the benefit of all stakeholders.

This promising activity can also be attributed to the recent legislation\(^5\) that releases managers, directors and any other person entrusted with the management of a banking institution’s estate from any liability arising therefrom within the scope of a restructuring, rehabilitation, special administration procedure or haircut of debts and claims. Finally, provision of financial support has also been relatively low, making it thus very hard, if not highly unlikely, for SMEs, which dominate the Greek economy, to gain access to financial help from the banks. An exception to this practice is lately noticed within the scope of a restructuring procedure, in which case the banks rely upon a well drafted business plan and are more willing to proceed with a refinancing of the existing debts, especially in view of the preferential ranking of claims arising from such agreements.

\section{Impact of specific regional or global events}

Undoubtedly, ‘Brexit’ (after the referendum in United Kingdom regarding its membership in the European Union) has created new conditions. While it is very hard to quantify the exact consequences, both political and financial, of this event, no one can claim that this will be an easy path for either side. A first estimation is that Brexit will have a great impact on immigration, as the United Kingdom shall be able to restrict immigration from Europe, depending on their future relationship. It is likely that Britain will restrict the number of low skilled workers entering the country and will focus more on highly skilled workers. In any case, Britain will design specific and probably strict migration requirements that will affect

\(^3\) Article 125 of the TFEU.

\(^4\) Executive Committee Act 118/19.05.2017 ‘Framework of establishment and operation of credit servicing firms (Law 4354/2015) – Replacement of Executive Committee Act 95/27.5.2016’.

\(^5\) Article 65 Paragraph 2 of Law 4472/2017.
Greece, as many highly skilled Greek workers have moved to UK. On the other hand, this could be a good outcome for Greece as they will contribute their know-how and thus, help Greece increase its competitiveness.

Among others, trade and manufacturing as well as financial services will be affected, since Britain will be considered a third country and thus, tariffs shall be imposed on imports and exports. Regarding financial services, Britain may also lose its ‘passporting rights’, which currently allow UK-based institutions to provide services to the European Union without having a branch in another Member State. The loss of such rights may lead UK-based banks to establish a subsidiary in the European Union in order to process business there regardless of the fact that such work may be essentially done in London.6 Such outcome could also be positive for Greece and its maritime economy, as many shipowners cooperate with British banks and could lead to an increased presence of British banks and bank services on Greek territory.

Despite Brexit and contrary to what many analysts and journalists had reported, the Netherlands was not another domino that fell to populism and the staunchly anti-Islam, anti-EU and anti-immigration PVV party of Geert Wilders lost the elections. The same happened in the French presidential elections, in which Emmanuel Macron and his party, who are seeking EU reform as well as deeper European integration in the form of a eurozone budget and eurozone finance ministers, won, thus keeping alive the European dream. While many were afraid that Europe would crack under the test of all the upcoming European elections, it seems that anti-populism and sanity make slow but steady victories. It is likely that this will also happen in the German elections. It goes without saying that all these political events do affect Greece, both in terms of its membership and role in the European Union and the handling of the Greek debt.

Apart from the economic recession, Greece is struggling under the weight of what is perhaps in its recent history the largest refugee crisis in scale. Greece has become a country of entry and transit for hundreds of thousands of refugees from the Middle East. It is estimated that 1.03 million people have entered Greece since 2015, of which at least 57,000 are stranded in Greece after the closure of the borders on March 2016. Consequently, Greece is also grappling with a huge number of asylum applications and an ineffective immigrant detention system, both of which entail high administrative costs and expenditures that Greece cannot afford. The refugee crisis has had a deleterious effect upon the political environment and has raised questions about how the refugees will be integrated into society, public schools and the public health system. Undoubtedly, this will be a substantial budgetary cost for Greece, which is difficult to address due to fiscal and budgetary adjustments.

iii  Market trends in restructuring procedures and techniques
A large number of medium-sized companies proceed with informal and out-of-court restructuring following a mutually agreed business recovery scheme with the banks, under which the banks have become involved or take over the debtor’s management and look for a potential investor. This is heavily applied to outward-looking companies that have increased exports activity, such as those of the aquaculture industry, or those that have good potential to remain sustainable and regain their profitability because of their financial contribution

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to the Greek market, such as companies in the food industry (mainly supermarkets). Small companies usually apply for a formal restructuring procedure, which is typically a longer and costlier process.

Although the competent authorities do not regularly issue a report regarding the insolvency statistics, the Hellenic Statistical Authority recently published some figures referring only to the bankruptcy procedure and for the period of 2004–2014. According to these statistics, the average number of companies that applied for a bankruptcy procedure each year during the said period, amounts to 1,061. Of these petitions, 914 (86 per cent) were accepted and 457 bankruptcies were declared. Moreover, of these statistics, 42 per cent concerns sole proprietorships, 11 per cent partnerships and 47 per cent entities limited by shares. The most bankruptcies have been recorded in the industry of retail and wholesale (45.7 per cent), the industry of manufacturing (22.8 per cent), the hotel and food services industry (11.6 per cent) and infrastructure industry (5 per cent).

Unfortunately, there are no formal reports regarding the number and course of bankruptcy applications. It is estimated that the time required to resolve insolvency cases is three-and-a-half years, and the recovery rate is 35.6 per cent. More than 16,000 SMEs closed in 2015, while 229,000 SMEs closed within the period 2008–2014. In 2018, 32,379 businesses were registered and 18,632 were deregistered, creating a positive result again.

iv  Formal procedures entered into or exited

In general, the recent amendments of the Bankruptcy Code create three keystone frameworks, for its further modernisation, which are explained in Section III, infra, and can be summarised as follows:

- enhancement of the restructuring procedures of entities in order to maximize their value to creditors, employees and the society in general;
- enhancement of the procedures available to debtors and creditors in order to enable an efficient restructuring of viable entities or an expedited insolvency proceeding for non-viable entities;
- provision of rules that enable an honest entrepreneur to try a fresh restart, especially when he or she could not succeed despite his or her good faith efforts;
- introduction of additional procedure to enable a swift debt settlement process under specific conditions and
- introduction of a more elaborated legal framework for the sale and management of NPLs and NPEs.

Regarding the formal procedures exited, it should be noted that the (once more) reformed Bankruptcy Code has abolished the process of initiating a restructuring procedure with an initial period, during which the debtor and his or her creditors would negotiate with the participation of a mediator, in order to reach a compromise agreement. This abolishment emerged from the fact that many debtors fraudulently and tediously initiated this process, in order to secure suspension of enforcement, but in reality, had no intent to reach a compromise agreement with their creditors. Thus, the restructuring procedure is now effectuated only with a pre-pack deal, namely an advance compromise agreement that is submitted before the court, for its ratification, together with the petition for the opening of the process.

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Moreover, the new Bankruptcy Code has abolished the special liquidation procedure, as its practice had been very limited. The explanatory report of the new law provides two reasons for the abolishment of the special liquidation procedure; the first refers to the existence of a very similar process, which is the special administration procedure of Law 4307/2014 and the second refers to its nature, namely the fact that it addressed very specific needs and thus, it was subject to continuous amendments that are not congruent with the objectives of a codified Bankruptcy Code.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Legal entities
Greek law provides with a series of insolvency and pre-insolvency procedures to which a Greek-seated company may be subjected to at the initiation of its creditors.

More specifically, the main insolvency processes are provided for and regulated by the provisions of Law 3588/2007 as amended and in force (the Greek Bankruptcy Code), as well as the provisions of Law 4307/2014 (Articles 68 et seq.) on special administration. The main processes may be outlined as follows:

a bankruptcy and reorganisation (voluntary liquidation);
b bankruptcy (plain vanilla) (involuntarily);
c rehabilitation or restructuring (pre-pack); and
d special administration.

Voluntary liquidation
Voluntary liquidation is commenced by the entity itself, through its board of directors or a relevant management body. A legal entity must file a bankruptcy petition within 30 days following present cessation of payments, in a general and permanent way. Moreover, the Code provides that voluntary liquidation can be filed, anytime, in case of imminent cessation of payments or possibility of insolvency.9 A general and permanent inability of the legal entity to satisfy monetary obligations as they become due and payable may be present or imminent; essentially, a foreseeable result of illiquidity. In any case, present or imminent inability or possibility of insolvency, as the case may be, must exist at the time of the filing of the bankruptcy petition. Regardless of the existence of any of the aforementioned criteria, bankruptcy will not be declared if the court, based on the financial data submitted, believes that the assets of the entity cannot cover the bankruptcy’s expenses.10

Once the court declares the legal entity bankrupt, the entity is placed in receivership. For this, the court appoints an insolvency practitioner (syndic or bankruptcy trustee) to start the liquidation proceedings and manage the legal entity’s assets and liabilities. The

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8 According to the new Paragraph 4 of Article 5 of the Bankruptcy Code, the debtor must also submit his or her financial statements, if they exist, for the last available fiscal year as well as certificates witnessing the amounts of his or her debts, issued by the state.

9 This criterion was recently added, by virtue of Article 1 Paragraph 1 of Law 4446/2016.

10 Initially, the existence of assets that could cover the bankruptcy’s expenses constituted a negative condition, namely a reason for the court to reject the respective petition. Now, according to Article 1 Paragraph 1 of Law 4446/2016 it has become a positive condition to accept the petition, thus expediting the procedure and rendering it more efficient.
court may also appoint the legal entity’s management body (debtor in possession), which shall manage its assets and liabilities, along with the insolvency practitioner, and until the union of the creditors, granted that such appointment is in the interests of the creditors. The court, moreover, designates the date and place whereby the creditors shall convene before the judge rapporteur to discuss about the debtor’s financial condition and sustainability, the reasons for bankruptcy, the perspectives to maintain the debtor’s business and to file a reorganisation plan, as well as the probable outcome for the satisfaction of creditors. The court, finally, designates the date that the present cessation of payments occurred, which cannot be more than two years prior to the date of declaration of bankruptcy and in case of imminent cessation or probability of insolvency is the date of publication of the bankruptcy’s declaration.

The declaration of bankruptcy has the following significant results:

1. the acknowledgment of the entity’s assets that exist at the time of filing the bankruptcy petition as ‘non-exempt’ property that is required for liquidation purposes;
2. any claims not due at that time become immediately payable; and
3. the suspension of all individual enforcement actions and proceedings, either future or existing, against the entity and its legal representatives.

The entity may file a reorganisation plan, in the case of present or imminent cessation of payments, but if insolvency is probable then the entity is obliged to file a reorganisation plan along with its bankruptcy petition, or within three months from its declaration of bankruptcy. The creditors, who represent 60 per cent of the total claims, including 40 per cent of secured creditors, may also file a reorganisation plan in case of permanent cessation of payments. The reorganisation plan must provide information regarding the corporation’s financial situation and the reasons thereof, a description of the current or future measures to be taken to secure satisfaction of creditors, and the creditors’ rights and legal status. Moreover, it may be subject to modifications and may now include provisions on the sale of the entire or part of the business. Similarly, to the restructuring procedure, the special mandator (appointed by the court in such cases) is entitled to substitute shareholders or stakeholders that deny their presence or vote for decisions that are required under the reorganisation plan applies here.

Approval of the reorganisation plan requires a majority of 60 per cent of the total claims, which include 40 per cent of secured creditors. Then the reorganisation plan is ratified by the court and has a cramdown effect, thus binding all creditors, regardless of their participation or consent.

Involuntary liquidation

Involuntary liquidation is commenced either by any creditor with a relevant legitimate interest in case of present cessation of payments, or by the prosecutor for reasons of public interest (very rare in practice). The time and procedure of filing are the same as those of the voluntary liquidation. Moreover, creditors who represent 60 per cent of the total claims, which include 40 per cent of secured creditors may also file a reorganisation plan along with the bankruptcy petition. Following the pre-review of the plan by the court and before the commencement of
the voting by the creditors, the entity (debtor) must approve the plan. Any objections raised by the entity do not prevent ratification by the court, if the court believes that the plan will not impair the legal status of the entity.

**Restructuring procedure**

The restructuring procedure \(^{14}\) is a pre-bankruptcy procedure that aims to restart and ‘rescue’ an entity’s going concern, while safeguarding creditors’ best interests. An entity in cessation of payments or approaching the imminent cessation of payments, or even probable insolvency (estimated as such by the court), may submit for ratification before the court a creditors’ compromise agreement (pre-pack deal), which must be approved at least by the supermajority (60 per cent) of the creditors, including 40 per cent of secured creditors. The procedure of initiating a restructuring, during which the debtor and his or her creditors would reach a compromise agreement has been abolished, in order to avoid fraudulent actions by the debtors. The deal must be structured in a manner that it will not impair collective enforcement by all creditors. Namely the rehabilitation must not leave non-participating creditors in a worse position in terms of the satisfaction of their claims than they would have been in a plain bankruptcy process.

The new Bankruptcy Code provides that from the date of the pre-pack deal submission until the issuance of the court’s decision, all enforcement actions against the entity are automatically suspended for a maximum period of four months. Suspension can occur only once, and after the lapse of the four months, suspension is allowed only through a court (interim measure) decision. The court decision that ratifies or rejects the rehabilitation plan is subject to appeal before the competent court of appeal.

An innovative provision of the new Bankruptcy Code states that both automatic suspension and any further provisional measures may take place even before submission of the creditors’ compromise agreement for ratification if: (1) the petitioner produces a written declaration signed by creditors, representing at least 40 per cent of the total claims; and (2) the conditions of an emergency or imminent danger of the parties are met. Such measures shall be in force until the submission of the pre-pack deal and in any case for four months from the court’s respective order. It is noted that no extension of such measures can be ordered.

Until now, only the debtor could submit a pre-pack deal. The new Bankruptcy Code provides that creditors may also submit a pre-pack deal, without the debtor’s consent, if: (1) such deal is executed by the supermajority (60 per cent) of the creditors, including 40 per cent of secured creditors; and (2) the debtor is under present cessation of payments. In this case, the creditors must also file a petition for bankruptcy.

Regarding the conditions for the ratification of the restructuring plan, the court may ratify the restructuring plan regardless of the entity’s sustainability thereafter if it concludes that the following conditions have been met cumulatively:

\(a\) the restructuring plan includes an explicit statement that all participating creditors have agreed to its content;

\(b\) the restructuring plan includes a detailed analysis of the participants’ identity (creditors or not) and their claims, as well as clear reference to those claims whose enforcement may be affected by the restructuring plan; and

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\(^{14}\) Article 99 of the Bankruptcy Code.
the restructuring plan along with the business plan is disclosed by a court bailiff to all non-participant creditors whose claims may be affected by the restructuring plan.

Furthermore, the new Bankruptcy Code introduced a new role for the special mandator. The court could also appoint a special mandator, who is responsible for certain actions, the safeguard of the debtor’s property etc. Currently, in the case of a pre-pack deal, due to present cessation of payments, the special mandator appointed by virtue of the ratification decision, is entitled to substitute any shareholder or stakeholder in the respective meetings, if such shareholder or stakeholder: (1) denies his or her participation or vote for the approval of actions required under the pre-pack deal either after its submission or as condition precedent; and (2) it is probable that he or she shall not participate in the liquidation proceeds. The special mandator shall exercise the aforementioned rights granted that the shareholder’s declared abstention or negative voting impairs the quorum and majority percentages. The same right (along with its limitations) applies in all other cases of a pre-pack deal ratification, if abstention or negative voting by the shareholder or stakeholder is a result of abusive behaviour.

Special administration procedure

Special administration procedure is provided under Law 4307/2014. The special administration procedure is always involuntary for the debtor company, as it may only be initiated by the company's creditors. It is mainly a ‘weapon’ for creditors to take over the business of their debtor in order to sell and transfer the entire business or its assets (not liabilities) by means of a public tender process and to satisfy their claims with the proceeds. So far, few entities have been subject to special administration such as the ongoing case of the distressed Hellenic Shipyards Co at Skaramangas, where the special administrator has initiated the sale of assets of the company through public tenders. Our firm successfully represented Hellenic shipyards under special administration in the proceedings before the Greek courts with respect to the ICC final award against the Greek state.

The competent courts may place a company under special administration when the company has reached a cessation of payments status. The court may also place a company under special administration in the following cases: non-publication of financial statements for five consecutive fiscal years, the company’s own equity is below one-tenth of its share capital for two years and the shareholders’ meeting has not taken any corrective measures, the company has a lower share capital than the statutory requirements, and the company’s initial share capital has not been paid up.

In fact, any entity in cessation of payments or in case of a company, which meets, for two consecutive fiscal years, any of the conditions for judicial dissolution, under Article 165 of Law 4548/2018 can fall under the special administration procedure, following a petition of its creditors, including a credit institution (including a bank or a leasing or

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factoring company), representing at least 40 per cent of the total claims. The petition must also be accompanied with a declaration by the proposed special administrator, accepting his appointment and it is filed with the single-member first instance court of the district in which the company has its registered seat. It is noted that the court decision placing a company under special administration is not subject to an appeal. The special administrator is a natural person (lawyer, accountant or auditor), that has been duly certified by the Greek Ministry of Justice. The special administrator is proposed to the court by the company’s creditors in their application for the placement of the company under special administration. The court decision that has placed a company under special administration is not subject to appeal.

The special administrator as an independent third party has 18 months, which may be extended by 6 months, to complete the process, unless at least 90 per cent of the total assets have been sold and the special administrator thinks that based on the announcement of claims, the proceeds suffice for their entire satisfaction, in which case he may request for an extension. In any case, the shareholders and the board of directors are removed from the management of the company and the special administration process. If the special administrator fails to sell the company’s assets, he or she must file for a bankruptcy petition.

**Compulsory administration under the Code of Civil Procedure**

The Code of Civil Procedure provides that the court may impose a special administration upon the real estate property or even the business of the debtor, following a creditor’s petition. Such an order is issued only if the creditor’s claim is judicially verified and thus, the creditor has obtained a respective decision allowing him or her to enforce his or her claim against the debtor.

It should be mentioned that this procedure is not acknowledged as an insolvency or liquidation procedure, but as an alternative means granted to the creditor to satisfy his or her monetary claim. These provisions are not largely regulated, and thus, initiation of such procedure is not widely recorded. It appears that special administration is more applicable to very small businesses or merchant individuals. Nonetheless, in 2013 a large construction company was the first-ever debtor to be placed under special administration, following the respective petition of a minority creditor. As the court explained in its headnotes, courts may not impose a special administration upon a real estate property or business of the debtor if, among others, there are compelling reasons for not doing so. Compelling reasons are those that render the special administration unprofitable, that the business’s operation and success is closely related to the personal reputation and contribution of its managers or partners, or that the business’s operation falls within the provisions regarding the protection of trade secrets.

### ii Insurance companies

On 5 February 2016, the Greek legislator abolished all the provisions that applied to insurance companies, by virtue of Law 4364/2016 (the Law). The Law is in compliance with Directive 2009/138/EC, regarding the undertaking and operation of insurance and reinsurance companies.

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17 Article 69 of L. 4304/2014, as amended by article 34 paragraph 1 of L. 4599/2019.
18 Decision No. 5461/2014 of the Single Member Court of Appeals of Athens.
19 The old provision is the Legislative Decree 400/1970, as amended by the Presidential Decree 332/2003.
According to the Law, such companies are required, as an integrated part of their business strategy, to maintain tools to proceed with a regular practice of assessing their overall solvency needs. The results of each assessment should be reported to the supervisory authority, which is the Bank of Greece.

The new provisions aim to create a trustworthy environment and minimise unexpected liquidations of insurance companies that have severe financial and social results. In this respect, Article 235 of the Law provides that insurance companies are not subject to the rules of bankruptcy or pre-bankruptcy proceedings. As such, the Bank of Greece is the only competent authority to decide on the revocation of its licence as well as on the restructuring measures for an insurance company, including the rise of capital, mandatory transfer of portfolio, suspension of payments to third parties etc., as well as on the winding-up proceedings following the suspension of their licence.

In the case of winding-up, the priority of claims is as follows: (1) employees’ claims arising from employment contracts and employment relationships; (2) claims of the state arising from due taxes; (3) pension funds claims; and (4) claims on assets subject to rights in rem.

### iii Credit institutions

According to the new rules on credit institutions, Article 145 Paragraph 1(a) of Law 4261/2014 provides that, subject to the specific provisions of Law 3458/2006 on Restructuring and Liquidation of Credit Institutions, such undertakings are not subject to the rules of bankruptcy or pre-bankruptcy proceedings.

To this extent, Law 3458/2006 provides for a special liquidation procedure that may be voluntary or involuntary. In any case, if the Bank of Greece suspends the licence of a credit institution, then such undertaking is immediately placed under involuntary liquidation.

### iv Investment services companies

There are a number of laws applying to investment companies, depending on their nature and the investment services provided. Thus, Law 4514/2018 applies to investment services firms and investment intermediation firms, Law 3371/2005 applies to portfolio investment companies, Law 2367/1995 applies to closed-end investment companies, Law 2778/1999 applies to real-estate investment companies and real-estate mutual funds, Law 2992/2002 applies to venture capital funds, Law 2367/1995 applies to venture capital companies, Law 4099/2012 applies to undertakings for collective investment in transferable securities (UCITS) and their managers and Law 4209/2013 applies to alternative investment funds and their managers.

In general, investment companies can be declared bankrupt, subject to explicit provisions of the law that require a specific liquidation procedure supervised by the competent authority. In this respect, Article 90 of Law 4514/2018 provides that a bankruptcy proceeding may be suspended if the Hellenic Capital Markets Committee revokes the licence of the company concerned (for reasons provided in Article 8 of Law 4514/2018), then a special liquidation procedure is commenced.

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It should be noted that Article 2 Paragraph 3 of Law 3458/2006 on Restructuring and Liquidation of Credit Institutions, as amended by Law 4335/2015, also applies to investment companies that are established as parent companies in Greece and that have subsidiaries in another Member State. It remains to be clarified whether this new amendment, which provides for a restructuring procedure rather than bankruptcy and liquidation, shall be applied to investment companies established as parent companies in Greece that do not have any subsidiaries in the EU area.

v Non-merchant individuals

Individuals that are not merchants are exempted from bankruptcy proceedings and fall under the protection of Law 3869/2010, which introduced measures to protect financially distressed individuals and households, such as extension of payments, increase of the number of payment instalments and deletion of debts. The debtor must file a petition before the Peace Court satisfying all statutory requirements, including a detailed certificate of debts, the status of personal assets and income, and the status of the creditors’ claims. The Peace Court will then try to achieve a pre-judicial compromise, but this stage has had a low success rate in practice. The Peace Court, thereafter, issues a preliminary judgment that suspends all enforcement actions against the debtor and orders the way and amount of instalments to be paid until the hearing date. The Peace Court’s final order sets out a binding adjustment of the debtor’s debts.

vi Informal methods to restructure companies in financial difficulties

Informal methods applied to restructure companies in Greece usually include the following:

a An amendment of debt repayment schedule, which is the plainest type of financial restructuring, aimed at making existing debt repayments consistent with the debtor business's projected cash flows. Such amendment may also be accompanied by an enhancement of lenders’ security and may also include some additional financing to cover urgent needs of the debtor.

b Standstill agreements, under which, debt repayments to banks and bondholders are suspended over a specified period for the purpose of negotiating and reaching a compromise agreement on the financial and operational restructuring of the debtor. Usually, standstill agreements provide the enhancement of participating lenders’ security and may also include some additional financing to cover urgent needs of the debtor, as well as some changes in the debtor’s management.

c Restructuring agreements regarding the financial restructuring of the debtor, combined with operational restructuring of the debtor, on the basis of a business plan and a management team approved by the participating lenders. Such agreements include various components, such as (partial) debt-to-equity conversion, the refinancing of the debt that is agreed as sustainable (by the debtor’s business and on the basis of the approved business plan), the taking of a new enhanced participating lenders’ security package and new working capital financing, for supporting or restarting the debtor’s operation and growth. According to the debtor’s financial position and type

21 Article 2 of Law 4335/2016.
of business, restructuring may include negotiations with the employees and suppliers and agreement on certain payment arrangements in respect of outstanding amounts, to enable the debtor’s stable operation.

d The above transactions would ideally take place with the participation of existing major shareholders, in the form of new equity contributions (a component that has been quite limited in Greece up until now) or of an investor capable of enhancing further debtor’s management efficiency, capital structure, and credibility in the Greek and international market.

vii Other laws relevant to insolvency and restructuring

**The taking and enforcement of security**

The new amendments to the Bankruptcy Code categorise Greece as an even more ‘creditor-friendly’ jurisdiction than before. The right of creditors to submit a pre-pack deal for ratification, without the debtor’s consent, in the case of present cessation of payments, the limitation of the available deadlines as well as the right of the special mandator to substitute shareholders or stakeholders that deny their presence or vote for decisions that are required under the pre-pack deal are major provisions that enhance the efficiency of the restructuring process and disregard any act that could jeopardise the operation of the entity in a way that promotes both creditors’ and society’s interests.

Moreover, financial assistance to companies is provided mainly by the banks, which enjoy multiple ways of security measures and a privileged enforcement, in case of insolvency. A bank providing a loan will take a mortgage on the company’s immovable property or a fixed or floating charge on its movable property, particularly on its inventory and equipment. A very important amendment concerns the priority of those claims that arise from financing of the entity in connection to a restructuring or reorganisation plan. Such claims are now the top priority and must be satisfied in full. Thus, banks that in most cases provide such financing are fully protected and satisfied, under the new Bankruptcy Code.

In fact, following the announcement of the creditors’ claims, within one month\(^2\) from the publication of the court’s decision and their verification by the judge rapporteur and the insolvency practitioner, within one month and granted that a reorganisation plan has not been concluded, the insolvency practitioner commences the realisation of the company’s assets (unsecured and secured). First in priority are creditors with general preferred privileges.\(^3\) The holder of the security in a specific asset of the company, whether immovable or movable, has a specific privilege (second class) and may be satisfied after the general preferred privileges. The third (last) class of priority includes unsecured creditors, who are satisfied after general and specific privileges. Nonetheless, before payments to any of the aforementioned classes,

\(^2\) Such deadline can be extended by the judge rapporteur for up to two months, only in exigent circumstances, because of the amount and nature of the claims as well as the number of the creditors. Article 93 Paragraph 1, Law 3588/2007.

\(^3\) General privileges, mainly, include: financing of the debtor for its continuing operations, claims arising from the contribution of goods and services to the debtor, based on the reorganisation plan or the restructuring plan, even those that were granted 6 months, in maximum, prior to the submission of the pre-pack deal; if the debtor is an individual (an insolvent merchant); costs and expenses for his or her funeral, hospitalisation, daily necessaries; claims from dependent employment agreement, periodical fees for services that arose within two years prior to the filing of bankruptcy; lawyers’ fees, value added tax claims, taxes, pension funds’ claims; and any claims of the state and the prefectures.
bankruptcy expenses, expenses concerning the management of ‘non-exempt’ property\(^{24}\) and claims of collective creditors\(^{25}\) must be paid in full. Moreover, if the three priority classes coincide, the proceeds are separated as follows: after the general preferred creditors who have granted financing, goods or services in connection to the restructuring or reorganisation plan receive full payment, then the rest of the general creditors receive 25 per cent of the proceeds, special preferred creditors receive 65 per cent and unsecured creditors receive 10 per cent.

\textbf{Duties of directors of companies in financial difficulties}

In Greece, the law sets out two different categories of the directors’ duties: the first category concerns the payment of the entity’s tax liabilities and social security contributions, while the second category concerns the initiation of the bankruptcy proceedings.

With regard to the first category, in case the entity fails to withhold, collect or pay income tax, VAT, or its respective share of social security contributions and any surcharges, the directors, administrators, executive managers and directors, as well as syndic or bankruptcy trustees (now insolvency practitioners) of a legal entity, are rendered jointly and severally liable for payment of such taxes and contributions\(^{26}\). This joint and several liability arises at the date of liquidation or merger or acquisition of the liable company. It should be noted though, that in the case of non-payment of withholding taxes (VAT, etc.) and social security contributions, the liability extends to all directors, administrators, etc., for claims arisen prior to and during their respective office.

A significant provision that should be mentioned is the extension of joint and several liability\(^{27}\), arising from all due taxes, to shareholders of the company who hold at least 10 per cent of the company’s paid-up share capital\(^{28}\), within three years prior to dissolution.

The second category of duties refers to the prompt and timely initiation of the bankruptcy proceedings by the company’s directors. The Bankruptcy Code envisages the joint liability of directors\(^{29}\) as well as of those who exercised undue influence on them, in case they fail to promptly file a bankruptcy petition, within 30 days from the date that there is present inability of the company to pay its liabilities as they become due. Such liability entails the restitution of creditors for damages arising from the reduction of the insolvency proceeds.

Similarly, joint liability is attached to the company’s directors if the cessation of payments is a result of a fraudulent or grossly negligent act\(^{30}\).

The importance of the bankruptcy rules, in terms of social and financial consequences, is also evident by the establishment of criminal liability against the company’s directors\(^{31}\).

\(^{24}\) ‘Non-exempt’ property refers to the bankrupt company’s assets as of the date of the bankruptcy’s declaration. ‘Exempt’ property refers to such company’s assets that are statutorily exempted from liquidation, such as necessaries, family rights, the debtor’s personality and his or her ability to work, rights that are strictly connected to his or her person (such as the right to use his or her name, to accept or waive inheritance rights, etc.).

\(^{25}\) Collective creditors are those creditors whose claims arose out of the insolvency practitioner’s actions in connection to the bankruptcy proceedings.

\(^{26}\) Article 50 of Law 4174/2013 and 31 of Law 4321/2015.

\(^{27}\) This extension is limited to amounts received by the shareholders as dividends or as payment in kind/cash and only for those claims that arose during acquisition of the shares.

\(^{28}\) Listed companies are exempted from such liability extension.

\(^{29}\) Article 98 Paragraph 1 of Law 3588/2007.


\(^{31}\) Article 176 Paragraph 1 of Law 3588/2007.
if they defraud creditors, conceal or fraudulently transfer assets of the company, dispose of inventory at very low prices, make false declarations or generally diminish the value of the company’s assets.

**Clawback actions**

Fraudulent exploitation of the entity's assets is also avoided through the annulment of specific transactions that took place in the statutorily determined suspect period. The Bankruptcy Code distinguishes between transactions that must be annulled and transactions that could be annulled.

The insolvency practitioner must proceed with the mandatory annulment of transactions made by the entity within the period of filing the bankruptcy petition and the declaration of bankruptcy (suspect period) and specifically:

a donations and gratuitous deeds or deeds that resulted in undervalued consideration for the entity;

b payment of debts that were not due and payable;

c payment of due debts with means other than cash; and

d imposition of security measures on the entity’s assets for pre-existing debts, when the entity had not undertaken such obligation or for new debts arising from a novation agreement.

On the contrary, the insolvency practitioner may proceed with the annulment of transactions, whereby the other party acted in bad faith, knew of the company’s cessation of payments and that such transaction was detrimental to the creditors' interests.

Similarly, if the company entered into transactions with the intent to defraud creditors or benefit other creditors within five years prior to the declaration of bankruptcy, these transactions may be annulled, provided that the other party knew of the company's intent.

Transactions that took place during the execution of a restructuring or reorganisation plan are explicitly exempted from such revocation.

It should be noted that there are some transactions that are exempted from bankruptcy revocation, even if entered into within the suspect period, specifically:

a regular business activities and arm’s-length transactions;

b the provision of services or goods by the company for which counter-consideration was an immediate and equivalent payment in cash;

c the granting of mortgage in favour of a company – especially a bank – according to Law 17.07/13.08.1923;

d the granting of pledge in favour of banks, regarding pre-existing claims from loans or open accounts, according to Legislative Decree 4001/1959;

e the creation of a mortgage or pledge to secure the issuance of bond loans or transfer of claims, according to Law 4548/2018; and

f the granting of security by special purpose vehicles (SPV) or other third parties in favour of banks, or other third parties to secure claims against the SPV, acting within the scope of a public-private partnership (PPP) agreement, according to Law 3389/2005.

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33 Article 43 of Law 3588/2007.
34 Article 44 of Law 3588/2007.
35 Article 45(e) of Law 3588/2007.
III RECENT LEGAL DEVELOPMENTS

The long-term financial and social distress of Greece highlighted the importance of the Bankruptcy Code and the need for its deep reform in order to restrain or at least reduce the serious impact of this crisis on enterprises, employees and employment. Thus, the Bankruptcy Code was recently updated by virtue of Law 4446/2016, which focuses on providing a second chance to honest entrepreneurs, enhancing the insolvency proceedings to avoid unnecessary delays and costs and enhancing the restructuring procedure in a way that preserves value and is beneficial for all stakeholders. These modifications are in alignment with the principles set out in the Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency,\(^\text{36}\) which promotes the restructure of economically viable but distressed businesses at an early stage and maximise the benefits for all stakeholders. These principles pervade the new provisions of the Bankruptcy Code.

The continuous changes to the Bankruptcy Code prove that national legislators are vigilant about the current needs of the market, the necessity to interfere efficiently in the operation of distressed businesses and the improvement of the corporate rescue framework. The recent amendments demonstrate a greater coherence and an increased efficiency in these rules that offer more opportunities and reduce costs and time loss.

i Regulation of the insolvency practitioner profession

Since 2015, the Bankruptcy Code provided for a new role: the insolvency practitioner. The insolvency practitioner is responsible for undertaking the duties of the syndic or bankruptcy trustee, mediator, special agent and special liquidator, as these duties are set out in the Bankruptcy Code. The profession of the insolvency practitioner is now regulated by virtue of Presidential Decree 133/2016, according to which a natural person can be appointed as an insolvency practitioner, granted that he or she has succeeded in the relevant national exams and has obtained the required licence.

In order to participate in these exams, the natural person must have exercised the role of lawyer, auditor or accountant of a class A profession for at least five years. The insolvency practitioner shall exercise his or her duties with integrity, independence, honesty and professionalism and shall be liable for any wrongdoing. Personal liability is attached only in case of wilful misconduct or gross negligence. Liability under the provisions of the tort law is not excluded. Moreover, the insolvency practitioner is supervised by the Insolvency Administration Committee, which is also responsible to keep a register of accredited insolvency practitioners, while the Disciplinary Board shall be responsible to monitor the insolvency practitioner’s appropriate conduct and to impose the statutory disciplinary measures, in case of misconducts.

ii Procedural changes in restructuring

The new Bankruptcy Code has simplified the restructuring procedure and introduced shorter and more internal proceedings, as explained below (see Section IV.ii, infra).

iii General changes in insolvency procedure

Provisions regarding the debtor’s duties

The new Bankruptcy Code provides for two basic amendments regarding the debtor’s duties: (1) the first concerns the duty of the debtor to submit along with the bankruptcy petition his or her financial data and a certificate witnessing the amounts of his or her debts, issued by the state. These additional documents shall help the court to have a more accurate picture of the debtor’s financial situation; and (2) the second concerns the appointment of the debtor as a manager of the entity’s assets (along with the insolvency practitioner), regardless of whether he or she filed for a bankruptcy petition. In fact, the only criterion is whether such appointment in favour of the creditors’ interests.

Changes in the bankruptcy organs

The infrequent use of the creditors’ committee, which was entrusted to monitor the bankruptcy proceedings and assist the insolvency practitioner’s duties resulted in its abolition. Thus, the creditors’ committee is no longer one of the bankruptcy’s organs. Moreover, the duties of the judge rapporteur have been upgraded. As of today, the judge rapporteur is responsible for deciding upon conflicts between the creditors, granting his or her consent for specific actions, such as sale of real estate property, supervising the proceedings during the auction of the business as well as convening the creditors’ assembly, following a request by the insolvency practitioner or creditors representing 20 per cent of the total claims to decide upon the sale of the business either as a whole or in part.

Extension of liability

The new Bankruptcy Code provides for an extended liability for both the insolvency practitioner and the board of directors or other management body of the entity. On one hand, the insolvency practitioner is liable for any default in the performance of his or her duties, while a liability towards third parties may be attached only in case of wilful misconduct or gross negligence. Liability under tort law is not excluded.

On the other hand, the board of directors or other management body are liable if they fail to promptly file a bankruptcy petition within 30 days of the date that the entity is unable to pay its liabilities as they become due. Such liability entails the restitution of creditors for damages arising from the reduction of the insolvency proceeds. Similarly, joint liability is attached to the entity’s directors or management if the cessation of payments is a result of a fraudulent or grossly negligent act.

Shortening of deadlines

In general, the deadlines of the insolvency procedure are shortened as follows: (1) the deadline for filing an appeal against the orders of the judge rapporteur is now 10 days from the issuance of such orders (previously 20 days); (2) the deadline for the submission of the

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37 Article 80 of Law 3588/2007. The insolvency practitioner is similarly liable for agents used, if he or she was not entitled to appoint them. Otherwise, the insolvency practitioner’s liability is limited to the appointment of such person and the directions provided.

38 Article 98 of Law 3588/2007. The same rules apply to those people who exercised undue influence on directors and managers, holding them jointly liable.

39 Articles 60, 70, 82 and 84 of Law 3588/2007, respectively.
report by the insolvency practitioner is now five days (it was previously 10 days) prior to the creditors’ assembly and must be published in the Bulletin of Judicial Publications of the Jurists’ Pension Fund; (3) the deadline for the convention of the creditors’ assembly by the judge rapporteur is now five days (it was previously 10 days) prior to such meeting and must be published in the Bulletin of Judicial Publications of the Jurists’ Pension Fund; and (4) the deadline for the convention of the creditors’ assembly by the judge rapporteur is now 10 days (it was previously 20 days) following verification of the their claims and the deadline for informing the debtor and insolvency practitioner about such convention is now three days (it was previously five days).

**Priority of claims**

By virtue of the recent Law 4512/2018, the priority of claims has been rearranged. According to Article 177 of Law 4512/2018, if, following the enactment of the law, there are entirely new claims that will be secured with assets that do not bear any encumbrances up to that date (of the enactment) then employment claims existing prior to the date of the bankruptcy declaration and concerning due salaries up to six months shall have super-priority for an amount up to the minimum wage provided for an employee above 25 years old multiplied by 275 per cent. This super priority is calculated per employee and per month for the six-month period, following the payment of legal costs, costs for the management of the bankruptcy property and other claims arising from the bankruptcy’s works.

After the satisfaction of this super priority, then the priority of claims is as follows: (1) financial facilities provided throughout the restructuring or reorganisation period, (2) special preferred claims, (3) general preferred claims and (4) unsecured creditors.

Creditors’ bankruptcy liquidation claims are classified into the following categories:

a Costs pre-deducted from the liquidation proceeds before the satisfaction of any other class of creditors, including:
   • judicial fees relating to the administration of the bankruptcy estate; and
   • claims of the group creditors (arising in the course of bankruptcy and as a result thereof).

b Claims that are equipped with a special privilege or lien over the proceeds in respect of certain movable or immovable property or over money including claims:
   • for expenses incurred in the six months before the declaration of bankruptcy with the view to maintaining the particular asset;
   • for the capital and interest accrued within the last two years for claims secured with an *in rem* security (pledge, pre-notice or mortgage); and
   • for expenses incurred for the production and harvesting of crops.

c Claims that are equipped with a general privilege or lien, including claims:
   • for new money injected or goods or services provided to ensure the continuation of the company’s activities and payments under a rehabilitation agreement, reorganisation plan or special administration procedure;
   • from dependent employees and lawyers;
   • from the state for value added tax and withholding taxes imposed with surcharges of any nature;
   • from social security organisations; and
   • from the state and local government bodies for all causes.
Unsecured claims and claims of secured creditors whose security does not suffice for the full satisfaction of their claims.

If more classes of creditors concur, after payment of pre-deducted claims (and if new money claims concur with unsecured claims following full repayment of the first category), creditors are satisfied as follows:

<table>
<thead>
<tr>
<th>Concurrent creditors</th>
<th>Percentages of liquidation proceeds for the satisfaction of claims</th>
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<tbody>
<tr>
<td>Secured</td>
<td>65 per cent</td>
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<tr>
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<td>25 per cent</td>
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<tr>
<td>Unsecured</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Secured (excluding specific claims)</td>
<td>66.6 per cent</td>
</tr>
<tr>
<td>Generally privileged</td>
<td>33.3 per cent</td>
</tr>
<tr>
<td>Secured</td>
<td>90 per cent</td>
</tr>
<tr>
<td>Unsecured</td>
<td>10 per cent</td>
</tr>
<tr>
<td>Generally privileged</td>
<td>70 per cent</td>
</tr>
<tr>
<td>Unsecured</td>
<td>30 per cent</td>
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According to this new ranking system, the above classes of creditors are satisfied in the following order:

- pre-deducted claims;
- claims of employees for salaries of up to six months up to a certain amount, which may be calculated on the basis of the law;
- claims for new money;
- secured claims;
- generally privileged claims and remaining secured claims; and
- unsecured claims.

Ranking cannot be amended.

The Bankruptcy Code provisions on creditors’ rankings are considered mandatory (ius cogens) and may not be amended through relevant contractual arrangements. Certain provisions of law refer to ‘creditors ranking last’ (subordinated creditors) (i.e., even after unsecured creditors). However, contractual arrangements altering the core provisions on ranking may not be followed in case of bankruptcy to the extent that they contravene mandatory code provisions.

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**Liquidation of small entities**

The new Bankruptcy Code provides for important amendments to the liquidation of small companies. The law identifies small entities as those that meet at least two of the following criteria: (1) have total assets amounting up to €150,000; (2) have a turnover amounting up...
to €200,000; and (3) employ up to five people on average. If two of the aforementioned conditions are met according to the write-downs of the inventory, the court declares the initiation of liquidation of the small entity.

Announcement of the creditors’ claims must take place within one month of publication of the court’s decision. Any delay in such announcement does not allow for a second chance and the creditor may not file a third-party objection before the court for the judicial verification of his or her claim, as provided in the regular insolvency process.

Sales of assets that are subject to deterioration, or undervaluation, or if their preservation is costly can proceed without the consent of the judge rapporteur. Prior to the creditors union, if the business is unlikely to operate or be sold entirely, then the insolvency practitioner may proceed with the sale of movable property and inventories following consent by the judge rapporteur. In this case, the debtor must be informed about such sale in order to raise any objections within three days. This obligation is not required after the creditors union.

Sales of immovable property take place in accordance with the regular insolvency procedure. If the first auction and its repetition within two weeks are fruitless, then the judge rapporteur may order the sale of the immovable property without an auction, following such request by the insolvency practitioner.

**Discharge of debts**

In compliance with the Commission Recommendation C(2014) 1500, the new Bankruptcy Code gives a second chance to honest entrepreneurs. In fact, the court, after reviewing the judge rapporteur’s report on the assessment of the causes and circumstance that led to bankruptcy and after hearing the insolvency practitioner on the same matters, may excuse the debtor, if he or she cooperated in good faith with all the parties involved, during the insolvency procedure. If the insolvency has been completed with the sale of the business, then the debtor may request to be excused and the court decides on the same aforementioned basis. If the debtor is excused, he or she may not be arrested and any forfeiture from rights is suspended. For an entity, the final ratification of the reorganisation plan or conclusion to insolvency due to the full satisfaction of creditors may be reasons for its revival.

Moreover, within two years from declaration of bankruptcy, the debtor may file for a discharge of debts and the court may discharge him or her for any outstanding claims if he or she can also be excused. This order must be issued within 60 days from the hearing. Of course, the debtor may not be discharged for claims arising from his or her wilful misconduct or gross negligence. In case the insolvency is completed with the ratification of a reorganisation plan, then the debtor is automatically discharged, unless otherwise provided therein. Finally, if the debtor is excused and three years pass from the declaration of bankruptcy, then the debtor is automatically discharged of his or her debts.

By virtue of Article 24 of Law 4549/2018 ‘Provisions for the Completion of the Agreement on Financial Objectives and Structural Reforms – Medium-term Financial Strategy Framework 2019–2022’ (Government Gazette B’ 105/14.06.2018), a second chance is also given to individuals that have not been declared bankrupt yet, but have already been registered with the Bankruptcies Registry by order of the bankruptcy court, following the rejection of a petition in bankruptcy, given that it was highly speculated that their belongings would not be sufficient for the payment of the costs of the bankruptcy procedure.

In accordance with Paragraph 5 of Article 167 of Law 3588/2007, which was added by virtue of Law 4549/2018, the non-bankrupt debtor or individual that has been registered with the Bankruptcies Registry has the option to file a petition before the competent court
in order to be declared excusable, which constitutes condition for the discharge of debts. The judgment on whether the debtor is excusable or not is based on the review of the causes and conditions of the case and the comments of the creditors.

Further, based on Paragraph 2 of Article 168 of Law 3588/2007, which was added by virtue of Law 4549/2018, a non-bankrupt debtor or individual that has been registered with the Bankruptcies Registry, according to the above, may file a petition for discharge of debts after the elapse of three years from his or her registration with the GEMI (General Registry of Commerce) and the Bankruptcies Registry. It is noted that the above provisions are also applied to non-bankrupt debtors that were registered with the Bankruptcies Registry since 1 October 2016 onwards, and to cases pending when these entered into force (i.e., 14 June 2018). Therefore, any relevant petitions for the discharge of debts of non-bankrupt debtors or individuals may be filed from 1 October 2019.

iv Regulation of NPLs
Significant achievements in the legal, judicial and overall NPL management framework have been introduced in Greece within the last two and a half years, which could be highlighted in the following areas: an out-of-court workout framework has been enacted, amendments in the Greek Bankruptcy Code satisfactorily address the previously identified impediments, changes in the Code of Civil Procedure appear to have set the basis for much improved efficiency in the enforcement of security rights (including electronic auctions), the issue on the liability of banks’ restructuring personnel has been addressed, and the profession of the insolvency administrator has been regulated, the issue regarding tax losses arising from sales of receivables has been resolved. Therefore, investors interest for any type of Greek NPE loan books is impressive, and demonstrates the willingness of international large pots of capital to tap into a highly underpenetrated NPE market, with significant potential, such as the Greek one. It is evident that resolution of the NPEs is the last, sizeable and challenging obstacle the Greek banking system will have to overcome. A few NPE transactions happened within 2018, and the effort to further intensify within 2019, is more than evident. The data of the Bank of Greece shows that the exposure of Greek banks to non-performing loans (NPLs) amounts to €81.8 billion, while efforts are being made to reduce them up to €38.6 billion (a decrease of 47 per cent) by the end of 2019. Of those non-performing loans, a portfolio amounting to €16.4 billion is expected to be disposed or fall under the special administration procedure.\footnote{Deloitte, Deleveraging Europe 2016–2017, page 32; https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/corporate-finance/deloitte-uk-deleveraging-europe-2016-2017.pdf.}

In fact, the pressure for liquidity led to replacements of the banks’ boards of directors, in order to ensure that a highly qualified management can face the current challenges of the banking sector. The law of NPLs has been recently modified in view of making the respective legal framework more attractive and easier for the management and acquisition of Greek NPLs.\footnote{Law 4354/2015, as recently modified by Article 70 of Law 4389/2016, Article 4 of Law 4393/2016 and Article 48 of Law 4472/2017.}

NPLs shall be managed: (1) either by special NPL asset-management companies limited by shares (with special and limited scope of business) that operate in Greece or in the European Economic Area; or (2) purchased and transferred to companies limited by
shares that operate in Greece or in the European Economic Area or in countries outside the EU and part of their business scope is to purchase and acquire claims from loans or credit agreements.

The regulation of NPLs sets out the requirements for the establishment and operation of the eligible companies. For a special NPLs asset management company to acquire permission to manage NPLs (and any collateral immovable property), it must file with the Bank of Greece, among others, its article of association, the identity of any and all natural or legal persons that have directly or indirectly a special participation in the company, the identity of any and all natural or legal persons that exercise control in the company, a business plan including the company’s projected actions, strategy and available resources, a detailed report of the methods and procedures to be adopted for such management and questionnaires that assess its ability and suitability to deal with the restructuring of NPLs. The Bank of Greece shall grant the required licence within two months of the submission of the respective petition. Furthermore, a management company must have a minimum share capital of €100,000, and if it wishes to finance new loans or credit agreements, a share capital of €4.5 million.

The acquisition of NPLs, on the other hand, does not require a specific licence but the acquiring company must have signed a management agreement with a special NPL asset-management company. The sale and transfer of such loans shall be effective only upon delivery of a written extrajudicial invitation to the debtor (and guarantor) to settle his or her debt within 12 months prior to such sale and transfer, according to a debt settlement agreement in writing. The acquisition is effective against third parties following registration of the agreement in the books of the Registry of Pledges and notification of the assignment to the debtors and any guarantors.

It should be noted that the sale and transfer of NPLs shall have an income taxation on the goodwill, borne by the acquiring company, while both management and acquisition agreements shall be subject to a VAT taxation of 24 per cent. Stamp duties are explicitly excluded for the agreements executed by the Special NPLs Asset Management Company.

Finally, Law 4472/2017 introduces a major provision according to which those persons who are responsible for supervising and or managing: (1) public property (including all kinds of state property or property of state-owned entities); or (2) property of a credit or financial institution are immune from any criminal or civil liability arising from their actions or failure in connection to the restructuring or discharge of loans, claims or charges, within the scope of the Bankruptcy Code or the law on the extrajudicial debt settlement procedure or the law on financially distressed individuals and households or the law on special liquidation of credit institutions or the law on the NPLs, and in accordance with the provisions of their internal regulations and guidelines, rules and procedures and applicable laws. These actions or failures to act must also aim to settle or restructure debts or assist the operation of the business and should not deteriorate the financial situation of the entity in comparison to that which would result from a liquidation procedure.

v Restructuring of municipalities and communities

Until 2014, municipalities and communities (M&Cs), as entities of public interest, could not declare bankruptcy. But the long-term financial crisis challenged their economic independency and sustainability and led to the introduction of Article 174 of Law 4270/2014

Companies established in countries outside of the EU may establish a branch in Greece provided that their registered seat is not in a non-cooperative country or in a country with a preferential tax regime.
on the Restructuring of Municipalities and Communities. The idea of this law is to closely watch the financial performance of M&Cs, alert their management bodies and impose restructuring measures in accordance with a respective plan.

The Financial Independency Observatory of M&Cs (the Observatory) is entitled to report to the Ministry of Internal Affairs as well as the M&Cs, the latter’s deviation of more than 10 per cent from budgetary targets and provide it with guidelines and methods to overcome such deviation. If the Observatory concludes that an M&C is incapable of drafting a preliminary balanced budget or fraudulently records false financial data, it is also entitled to draft a report of its financial situation and propose restructuring measures, in accordance with a restructuring plan. Moreover, M&Cs may apply for a voluntary restructuring, which is reviewed (rejected or approved) by the Observatory and the Minister of Internal Affairs.

The measures of a restructuring plan may include:

- suspension of recruitments;
- voluntary or involuntary transfer of employees;
- realisation of mandatory expenses;
- increase of municipal taxes, fees and contributions; and
- granting of a loan by the Deposits and Loans Fund.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

i Value and significance of the transactions

The value of distressed deals is difficult to assess, as the legal process typically involves the partial sale of balance sheet for the assumption of liabilities.

Attica Group

Attica Group is an international ferry boat operator, whose shareholders are Marfin Investment Group (MIG) representing 79.38 per cent of the share capital and Piraeus Bank representing 11.84 per cent of the share capital. MIG is willing to sale the ferry operator’s shares through the sale of share packages to investors attempting to restructure and reduce loan obligations. It is estimated that the Attica’s Group liabilities amount €356 million. Replying to a letter issued by the Hellenic Capital Market Commission, MIG has pointed out that it has received several offers from investors, that have already been rejected and there is no binding offer from an investor at this moment. Except for the above-mentioned, Attica Group is ready to issue a corporate bond worth €150 million in order to raise its share capital and finance the group’s loan restructuring. It is worth mentioning that Attica Group had previously issued a corporate bond that was covered entirely by Fortress fund. In this case the raised capital financed the restructuring of Attica’s Group subsidiary Blue Star Ferries’ debt.

Kalogirou Store

In 2018, Kalogirou Store, a branch of Lemonis Clothing & Footwear Group of Companies, was put under restructuring, following a petition filed by FAIS Group. According to the relevant decision issued by the Court, the new partnership, under the restructuring plan

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43 So far, two municipalities have applied for restructuring: the municipality of Salamina and Gortynia in Crete.
was consisted of FAIS Group, whereas Attica Group and Lemonis family were the minority shareholders. The restructuring plan’s goal was for the Lemonis Group to have a positive EBITDA as from 2018. The Group’s turnover is expected to reach the amount of €54.963 million in 2023. Over the same timescale, the Group’s EBITDA are expected to be positive (specifically €6.289 million in 2023), when in 2016 and 2017 were negative, coming up to -4,341 and -5,164 respectively. The Group’s liabilities, according to the restructuring plan, are expected to be reduced to €6.430 million in 2019 and €2.345 million in 2020, when in 2017 they came up to €70.456 million. In the long term (specifically in 2023), the Group is expected to achieve a profitability of up to €9.392 million.

**Notos Com Holdings**

Notos operates a number of department stores representing International brands, under the Notos Galleries and Notos Home brands in Greece. It was established in 2001 through a combination of several companies. According to its financial data, Notos Com Holdings had total liabilities of €230 million, including a total borrowing of €152 million. Due to its financial distress, Notos Com Holdings opted for the restructuring procedure in 2018, which was supported by Pillarstone, a non-performing loan platform (NPL) backed by KKR making its first investment in Greece. The deal was the first of its kind in Greece after the government reformed laws in order to better protect international investors and was made after months of negotiations with the four systemic banks of Greece, Alpha Bank, Eurobank-Ergasias, the National Bank of Greece and Piraeus Bank. The banks and Pillarstone invested €25 million in new funds, while the firm’s majority owner, Michalis Papaellinas, also invested in the structure. The restructuring plan included provisions for the reduction of the number of employees and the partial transfer of the Notos Home activities to the store at Stadiou & Eolou street, while one of the firm’s central stores sited in Kotzia square in Athens was closed after operating for 15 years.

**Marinopoulos Supermarkets**

In 2016, one of the largest supermarket chains in Greece was put under a restructuring procedure due to its financial distress. This case received great press coverage, since it was the first case of the specific industry and with financial and social interests of various stakeholders. The pre-pack deal provides for the establishment of a new company (NewCo), under the trade name ‘Hellenic SuperMarkets Sklavenitis SA’ in which Marinopoulos shall transfer assets amounting to approximately €715 million, liabilities amounting to approximately €1 billion, all its commercial claims and all its fixed assets. Sklavenitis SuperMarkets SA (another major player in the industry) shall acquire the NewCo and contribute in cash, through a share capital increase, an amount of approximately €125 million.

According to the pre-pack deal, which was ratified by the court, the restructuring plan envisages four basic components: (1) haircut of some claims; (2) extensions of credit line by the banks; (3) increase of the number of total instalments for claims towards the state and the Social Security Institution; and (4) specific provisions for the employees. In particular, claims of both secured creditors and unsecured creditors-suppliers of Marinopoulos (the latter’s claims amounting to approximately €647 million) shall be reduced by up to 50 per cent. Apart from Alpha Bank, which accepted a haircut of up to 20 per cent, banks (Alpha Bank, Eurobank, Piraeus Leasing, National Bank of Greece and National Leasing) shall receive full payment of their claims, amounting to approximately €196 million, within 20 years, after a five-year grace period and in 15 unequal instalments with interest, following a capitalisation
of any due interest amounts, which shall take place at the execution date of the pre-pack deal. Claims of the state and the Social Security Institution shall be paid in full and in 250 equal and interest-free instalments.

The banks agreed to extend the credit line of Marinopoulos with an amount up to approximately €55 million and provide a credit line to NewCo up to approximately €352 million. Apart from the share capital increase in the NewCo, Sklavenitis SuperMarkets SA and Marinopoulos Bros. Holdings SA shall also provide an interim financing of up to approximately €15 million and €10 million accordingly. It is noted that all existing employment, leasing and tenancy agreements shall be transferred to the new company. Moreover, any and all administrative licences, trademarks, permissions of use, inventory, equipment and furniture are transferred to the new company.

**Dias Aquaculture SA and Selonda**

The restructuring of Dias Aquaculture (Dias) was one of the first that occurred in the fish farm industry. Dias applied for a pre-pack deal, which included a transfer of Dias’ business to Selonda Aquaculture SA. In particular, Dias contributed in kind its total assets, amounting to €69 million, and part of its liabilities, amounting to €29.6 million, to Selonda’s share capital. A part of Dias’ liabilities, which constituted 81.95 per cent of its total liabilities would not be contributed to Selonda; instead, it remained within Dias’s financial statements and was covered with the acquisition of 41,261,980 shares issued by Selonda, in accordance with its share capital increase of €12.4 million. The newly issued shares were subsequently transferred by Dias to its creditors, on a pro rata basis, for their satisfaction. It should be noted that Selonda itself had also applied for a restructuring plan, which resulted in a haircut of its debts held by the banks, amounting to €50 million. Selonda is now managed and operated by a new management appointed by the participating banks, which is seeking an interested investor to buy out Selonda.

**ii Restructuring techniques used**

As normal methods of restructuring are not enough to save distressed companies in the Greek crisis environment, debtors and their creditors are led to more complicated solutions, depending on the nature and size of their business. In particular, large companies that were listed in the Athens Stock Exchange preferred to go private, through acquisition by an interested investor. A greater percentage of medium-sized companies resorted to techniques such as debt-to-equity conversion and debt-forgiveness agreements. In such cases, the banks, which usually hold the largest percentage of their debts, take over their management, proceed with drastic restructuring measures and then search for an interested buyer. Restructured companies – especially those with increased exports – are able to obtain new working capital financing. More advanced tools like a debt push-up, or even the creation of new group structures with lower debt levels or the consolidation of existing players in each sector, are also used to rescue viable businesses and recover part of the existing debt.

**iii Distressed industries and market trends**

The industries of construction, textiles, electric appliance stores and supermarkets have suffered the most severe financial losses within the Greek market. The reasons for such distress can be explained by the fact that they are all capital-intensive industries, with high running costs, squeezed profit margins and, in addition, are overleveraged (through abundant financing provided to them before the crisis). Profit margins have decreased even more now
that companies have limited access to working capital finance. Moreover, the recent changes in the income tax code, the real estate property taxation and the increase of VAT up to 24 per cent have significantly diminished the spending capacity of Greek consumers.

iv  The extra-judicial debt settlement

A long-awaited procedure was recently legislated; the extra-judicial debt settlement. According to Law 4469/2017, any natural or legal person may file a petition for an extra-judicial debt settlement provided that their total debts to the state, social security contributions and banks (default of payment for at least 90 days) or claims from a payment order issued by the court, as of 31 December 2018 amount to €20,000 at least. In case such person or entity has applied for or has begun a pre-bankruptcy or post-bankruptcy procedure or special administration or liquidation or such person or entity has been finally convicted for tax evasion or money laundering then it is not eligible for the extra-judicial debt settlement. Moreover, the person or the entity must have had for at least one of the last three fiscal years before the petition: (1) a positive EBITDA, if it uses a single-entry accounting system; or (2) a positive EBITDA or positive net position, if it uses a double-entry accounting system.

The petition must be submitted until the 31st December 2019 via the electronic platform of the Special Secretariat (Directory) of Private Debt Management. The petition must be accompanied by various documents, such as a creditors’ list, a list of all assets and any encumbrances, any affiliated persons, financial statements and various certificates. Thereafter, the special secretariat appoints a mediator who shall communicate with the debtor and the creditors and shall coordinate the procedure. Continuation of the procedure is subject to the participation of creditors, representing at least 50 per cent of the total claims (not including creditors that are affiliated with the debtor). The law provides that a joint decision by the Ministry of Finance, Ministry of Economy and Development, Ministry of Labour, Social Security and Welfare can promulgate that for debts up to € 300,000, the procedure is automatic, meaning that the creditors have to choose among predetermined solutions.

Upon notice of the mediator to the creditors to participate in the extrajudicial debt settlement, all enforcement actions (against claims set under the settlement) are suspended for a period up to 90 days. An extension of this period can be granted by the court, following petition of the debtor and approval by the majority of the creditors, for a period up to four months.

The debtor and the majority of the creditors shall appoint an expert to draft a restructuring plan, which may then be ratified by three-fifths of the represented creditors, including two-fifths of the represented secured creditors. Finally, the restructuring plan may be submitted before the court for ratification.

v  The pre-pack deal (rehabilitation or restructuring process)

Since its implementation in 2011, the pre-pack deal has a distinctive position within the scope of bankruptcy law. First of all, it offers a good chance to the interested parties to find a mutually acceptable solution. The new Bankruptcy Code provides that the submission of the pre-pack deal, which may regulate any aspect of the debtor’s assets and liabilities, is the only way to initiate the restructuring procedure, as it safeguards time and avoids delaying tactics by debtors. The recent changes that extend the circle of persons that can file for a restructuring procedure, allow creditors that represent at least 60 per cent of the total claims, including 40 per cent of the secured creditors to file a pre-pack deal without the debtor’s consent, if the debtor is in permanent cessation of payments, demonstrate a clear legislative
intent to accelerate the restructuring procedure and facilitate further business rescue. In case of cessation of payments, the filing of a rehabilitation application must be accompanied by a bankruptcy petition, in case the rehabilitation plan would be rejected by the court.

The key point in the legislation is that the court ratifies the rehabilitation plan without assessing the entity’s sustainability post- (proposed) restructuring, if the following conditions have been met cumulatively:

- The rehabilitation plan includes an explicit statement that all participating creditors have agreed to its content;
- The rehabilitation plan includes a detailed analysis of the participants’ identity (creditors or not) and their claims, as well as clear reference to those claims whose enforcement may be affected by the rehabilitation plan; and
- The rehabilitation plan, along with the business plan, has been disclosed to all non-participating creditors, whose claims may be affected by the restructuring plan.

Therefore, if the rehabilitation plan is ratified by the court, it is deemed binding upon all creditors, irrespective of their vote in favour or against the plan. There have been some reservations on the pre-pack deal, mainly focusing on potential ‘cloudy’ negotiations, the partial or significantly diminished satisfaction of unsecured creditors or the impairment of the entity’s value and the reluctance of Greek business men due to the misunderstanding caused by the fact that is regulated in the Bankruptcy Code, whereas in the contrary, as a pre-bankruptcy procedure is avoiding bankruptcy.

Despite those reservations, the case of the pre-pack deal was and continues to be successful in Greece, overturning those who believed that debtors and creditors cannot reach an amicable solution. The point that a restructuring plan not only promotes the interests of the creditors but mainly helps an entity stay alive, pay taxes, recruit and make a business plan evidencing its viability, is well received.

It should be noted that in a country where bankruptcy was considered a social stigma for many years – the ultimate nightmare of a successful businessman – the idea of the pre-pack deal demolished many prejudices. The legislator has given room to the interested parties to find a way out and act in both personal and public interests.

V INTERNATIONAL

The principles of unity and universality pervade the rationale of the Greek law, which is applied in insolvency proceedings that are initiated in Greece. The EU Regulation

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44 Unity and universality mean that the insolvency procedure, whether of individuals or legal entities, is one and the applicable law is that of the jurisdiction, where such procedure was initiated and any creditor, regardless of his/her residence, may participate therein.

45 Both the Bankruptcy Code and the Civil Procedure Code incorporate these principles. In particular, Article 780 of the Civil Procedure Code provides the requirements, regarding the recognition of foreign judicial decisions that: (1) the decision must apply substantive law, that according to the Private International Rules is applicable; (2) the decision must have been issued by the competent jurisdiction, in accordance with the substantive law of the jurisdiction applied; and (3) the decision must not be contrary to moral usage or public order. To the contrary, the EU Regulations 1346/2000 and 2015/848 provide for a more simplified recognition procedure, according to which the declaration of bankruptcy from the competent foreign courts is automatically recognised in other foreign courts, starting from the date of such declaration’s legal effects. The only exceptions to the automatic recognition are those of public order and individual rights.
1346/2000, and all later amendments, were integrated to the Greek insolvency laws in May 2002. Similarly, the UNCITRAL Model Law on Cross-Border Insolvency was implemented almost in its entirety through Law 3858/2010.

Nonetheless, Greek jurisprudence on international insolvency cases is very poor. In fact, there are two main cases\textsuperscript{46} that were successfully tried before the Greek courts, regarding the recognition of a foreign decision and the initiation of secondary bankruptcy proceedings.

Many provisions of the EU Regulation have superseded any bilateral or multilateral agreements on insolvency proceedings or recognition of foreign decisions. Unlike France and Italy, Greece has not signed any respective agreements, and thus, the EU Regulation 1346/2000 remains in full force.

According to Article 81 of the Treaty of the European Union and Articles 7 and 35 of Law 3858/2010 on Cross-Border Insolvency, the Greek courts must cooperate with foreign courts or foreign insolvency administrators directly or through such administrators. Similarly, the Greek courts are entitled to communicate directly, request information or judicial assistance from foreign courts or foreign insolvency administrators or coordinate cross-border insolvency proceedings with other participant Member States. Although these provisions stand for a considerable time period, no respective cases have been reported.

A recent development in the European Union concerns the abolishment of the EU Regulation 1346/2000 on 26 June 2017. Any and all insolvency proceedings commencing thereafter shall be governed by the EU Regulation 2015/848, as amended by EU Regulation 2017/353. Many novelties of the EU Regulation 2015/848 have already been implemented in the Bankruptcy Code through Law 4336/2016, such as the introduction of the insolvency practitioner and the rescue of viable companies, while the Commission's recommendations C(2014) 1500 have also been implemented by virtue of Law 4446/2016, including the expedited restructuring procedures and the rules for granting a second chance to honest entrepreneurs. Other novelties, such as the registry of insolvency, the interconnection with the respective registries of other Member States, publication to another Member State and the cooperation of insolvency practitioners both in main and secondary insolvency proceedings may be either implemented through further amendments to the Bankruptcy Code, or the new regulation shall be directly applied to cross-border insolvency cases.

**VI  FUTURE DEVELOPMENTS**

The amendments to the restructuring procedure follow the trends of the European law and the current practices and needs of the Greek market. For the first time, creditors are also entitled to file a pre-pack, without the consent of the debtor, if the debtor is in permanent cessation of payments. This is a crucial provision, as creditors have a chance to rehabilitate entities with growth potential, despite their permanent cessation of payments. It is likely that the law will extend this right also in case of debtors with imminent cessation of payments, as this will help even more creditors who are ‘trapped’ owing to misleading practices by their debtors. It should be noted that a proposal to extend the scope of this procedure as aforementioned cannot be confused with the bankruptcy procedure, in which case only the debtor can file a bankruptcy petition due to imminent cessation of payments. This distinction lies in the heart

\textsuperscript{46} Decision No. 494/2014 of the Single Member Court of First Instance in Kos and Decision No. 437/2013 of the Multi-Member Court of First Instance in Athens.
of restructuring; creditors granting a second chance to businesses that are viable and can grow further, with a good business plan, if they are ‘released’ from their bad management or inefficiencies of their owners.

Moreover, the abolishment of the special liquidation procedure as mentioned above, highlights the importance of the special administration procedure (as described in Section II. i, supra). In order for special administration to play the role required today, some amendments should also take place. These amendments refer to: (1) the provision of the debtor’s right to file for a special administration procedure, as now can be initiated only by creditors; and (2) the extension of the special administration’s scope in order to include imminent cessation of payments as well as probability of insolvency as events or conditions for the initiation of such procedure. Finally, a boost has been given to the Greek economy and all pre-bankruptcy procedures have been accelerated in order to attract foreign investors and thus there are increased chances to effectively restructure and ultimately ‘rescue’ distressed Greek companies.
I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

Hong Kong

China resumed its sovereignty over Hong Kong with the establishment of the Hong Kong Special Administrative Region of the PRC on 1 July 1997. The Basic Law – part of the constitution of Hong Kong – was adopted on 4 April 1990 by the National People’s Congress of China and provides for a 50-year period during which Hong Kong will be allowed to retain its current political, social, commercial and legal systems, including those that have made it an international financial and business centre.

Hong Kong operates a free trade economic system with minimal government intervention. A primary attraction is Hong Kong’s legal system, based on English common law and rules of equity, involving adherence to the principles of the rule of law and judicial independence.

Many head offices and holding vehicles for Chinese and foreign multinational corporations, financial institutions and regional investors with operations in China and South East Asia, have long maintained their base in Hong Kong. The Hong Kong Stock Exchange is one of the largest securities exchanges globally and a significant proportion of the companies listed on it hold assets and operations in China.

Given its proximity to and relationship with China, Hong Kong is often regarded as the primary intermediary platform for trade between mainland China and the rest of the world, serving a dual role as both conduit for access to the mainland Chinese market and a springboard for Chinese businesses to gain exposure to international markets.

Hong Kong remains a key offshore capital-raising centre for Chinese enterprises. As of the end of 2018, 1,146 mainland companies were listed in Hong Kong, with total market capitalisation of around US$2.6 trillion, or 68 per cent of the market total.2

Shanghai-Hong Kong Stock Connect was launched in late 2014 to establish mutual stock market access between Hong Kong and the Chinese mainland, with Shenzhen-Hong Kong Stock Connect following in 2016, consolidating Hong Kong’s development as the global offshore yuan business hub.

A new mutual market access scheme (called Bond Connect) was launched in July 2017, to allow investors from China and overseas to trade in each other’s bond markets through the

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1 Tom Pugh is a partner at Mayer Brown.
2 See ‘Economic and Trade Information on Hong Kong’ research from the Hong Kong Trade Development Council, at www.hktdc.com/Research (Economic Factsheet).
relevant mainland and Hong Kong financial infrastructure institutions. At present, overseas investors from Hong Kong and other regions may invest in the China interbank bond market through mutual access arrangements in respect of trading, custody and settlement.

ii Economic conditions

Overall debt market conditions have remained broadly borrower-friendly, in a low interest rate environment. There is an expectation that at some point liquidity is likely to tighten, which, coupled with rising interest rates, will increase pressure on debtors and expose some of the lower quality deals accepted by yield-hungry lenders.

Notwithstanding recent stimulus measures, it appears the mainland Chinese economy continues to lose momentum, which inevitably weighs on business confidence in Hong Kong. The escalation of the US–China trade war in May 2019, with increased tariffs on Chinese imports to the US, also appears to have dampened fixed investments and private spending, although the property and stock markets have rebounded well in the first quarter.

According to the United Nations Conference on Trade and Development World Investment Report 2018, global foreign direct investment into Hong Kong amounted to US$104.3 billion in 2017, ranked third globally, behind only the Chinese mainland (US$136.3 billion) in Asia, notwithstanding a decline from the previous year. In terms of outflows, Hong Kong ranked second with US$82.8 billion in Asia, after the Chinese mainland (US$124.6 billion).3

In China, myriad debt maturities and sector overcapacity, against the backdrop of ongoing US–China trade disputes, continues to raise uncertainty. An apparent increase in foreign investor interest regarding non-performing loan portfolios sits against a concern that prices for such assets may drop as quality deteriorates but supply increases. A crackdown on shadow banking to reduce risks in the financial system may also affect the ability of smaller enterprises to obtain new loans or refinancing. Chinese dealmaker conglomerates that incurred significant debts for overseas deals, many on short-term maturities, continue to firefight the pay down of borrowings, often through a sell down of assets. Unless operating in a crucial or strategic sector, significant PRC corporations may be left to address their offshore debt defaults alone without automatic bailout at the behest of government.

iii Market trends

Hong Kong operates a generally creditor-friendly approach to distressed enterprises but without the benefit of any statutory corporate rescue procedures (such as administration). However, the trend has continued away from liquidation and towards refinancing. Notwithstanding a small increase in 2009 following the global financial crisis, statistics from the Official Receiver’s Office4 show the number of compulsory winding-up petitions presented and orders made has broadly continued to decline. So where, for example, in 2003 the annual total petitions presented was 1,451 of which 1,248 received orders to be wound up, in 2018 the annual total petitions presented was 367, of which 255 were ordered into liquidation.

4 See www.oro.gov.hk/cgi-bin/oro/stat.cgi.
In Hong Kong, the scheme of arrangement has long been an important restructuring tool and that continues to be the case. As a number of entities listed on the Hong Kong Stock Exchange and otherwise are incorporated offshore, parallel schemes running in Hong Kong and the relevant offshore jurisdictions have become more common.

Interest in the Chapter 11 process has also grown in Asia over the past few years. The debtor-in-possession approach alongside the purported worldwide moratorium is attractive to the often family run management of large Asian debtors, although the cost can still be seen as prohibitive. The relatively easy grounding of jurisdiction in the US bankruptcy courts despite no US operations or even creditors adds to the attraction for debtors and concern for their bankers. Singapore’s recent legislative changes to enhance its existing scheme regime effectively to allow debtor-in-possession restructuring is an interesting development in the region, but it remains to be seen how quickly it will feel the benefits of such changes and what impact will be felt on views over preferences for debtor- or creditor-led processes.

Arguably, a trend over recent years has seen non-par investors repackaging existing debt into new instruments sufficiently attractive to other alternative credit providers, but ultimately leaving the underlying problems of the balance sheet unresolved. It remains to be seen whether a tightening of liquidity coupled with perhaps a downward pricing of asset values and rate rises will impact this model.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

Provisions covering the winding up of Hong Kong companies and foreign corporations registered in Hong Kong and the insolvency-related regime are found in the Companies (Winding-Up and Miscellaneous Provisions) Ordinance (the Winding-Up Ordinance) and subsidiary legislation. The Winding-Up Ordinance was amended by the Companies (Winding-Up and Miscellaneous Provisions) (Amendment) Ordinance 2016 (the Amendment Ordinance) and the new changes came into effect on 13 February 2017.

The statutory provisions applicable to individual bankruptcy as opposed to corporate insolvency are contained in the Bankruptcy Ordinance; and discussions below focus on corporate insolvency. However, certain provisions in the Bankruptcy Ordinance are also relevant to corporate insolvency to the extent that the Winding-Up Ordinance applies them specifically by reference. Other legislation that may also be relevant in the context of restructurings or insolvencies include the Transfer of Businesses (Protection of Creditors) Ordinance relating to the transfer of the business of a company in certain circumstances.

Insolvency of a Hong Kong company will generally result in a company being wound up by either voluntary or compulsory liquidation, the latter occurring pursuant to court order on a winding-up petition against the company. There are additional statutory provisions that are applicable in the case of certain regulated industries, such as banking and insurance, and there is also power for the government to petition for the winding up of a company if considered expedient in the public interest.

Much of the Winding-Up Ordinance and related rules date back to the English Companies Acts of 1929 and 1948, but without English insolvency law revisions for administration. While the government announced that it intends to introduce an insolvency reform bill that will provide for the introduction of a provisional supervision regime, akin to English administration, and the concept of insolvent trading, the timetable for such a bill’s introduction remains uncertain.
i Voluntary winding up

Voluntary liquidation may occur when the company is solvent, which is known as a members’ winding up; or when the company is insolvent, which is known as a creditors’ voluntary winding up.

A voluntary liquidation is started by a members’ resolution and then will become a members’ winding up if a certificate of solvency is issued by a majority of the company’s directors, noting their opinion that the company will be able to pay its debts in full within a period not exceeding 12 months from the commencement of the winding up specified in the certificate. If no certificate of solvency is made or if it is not effective because other prescribed criteria are not satisfied, the winding up will be a creditors’ voluntary winding up. The Amendment Ordinance has enhanced the requirements relating to the first creditors’ meeting upon the commencement of a creditors’ voluntary winding up.

The legislation also, uniquely, provides for a procedure allowing directors of a company to commence voluntary liquidation without holding a shareholders’ meeting. Instead, the voluntary liquidation is initiated by a directors’ meeting, resolving (among other things) that the company cannot by reason of its liabilities continue its business, the directors consider it necessary to be wound up and that it is not reasonably practicable for the company to be wound up under any of the other procedures prescribed in the legislation, giving supporting reasons. The Amendment Ordinance has introduced additional safeguards to reduce the risk of abuse in a director-initiated creditors’ voluntary winding up. In any event, the procedure is not frequently used, given the general availability of other procedures.

ii Compulsory winding up

Compulsory winding up pursuant to a court order is based on a petition presented usually by a creditor, although a shareholder or the company itself may also petition in appropriate circumstances. The legislation provides various grounds upon which a petition can be presented, the most common of which is an inability of the company to pay its debts, a matter that may either be proved on the balance of probabilities by the petitioner or deemed where the company has failed to pay or otherwise satisfy a statutory demand within three weeks of that demand being served on the company; and another of which is that it is just and equitable for the company to be wound up.

The legislation does not provide a specific definition of ‘insolvency’, instead, referring to the inability to pay debts, which is deemed to have occurred on satisfaction of one or more of the bases prescribed in Section 178 of the Winding-Up Ordinance. In considering an inability to pay debts, the court may consider applying either the cash flow or the balance sheet test.

For a creditor to bring a winding-up petition, there must be a debt (present, contingent or prospective) for a liquidated sum due from the debtor company to the creditor. Where the debt is not yet due, but is to fall due in the future or is contingent, the court will not hear the petition unless security for costs are provided and a prima facie case for winding up is demonstrated. If a debt is the subject of a genuine dispute, it cannot found the basis of a winding-up petition. Further, for the debt to be capable of supporting a winding-up petition, it must be at least HK$10,000.

iii The liquidator and committee of inspection

In Hong Kong there is no requirement for liquidators to be licensed, as is the case in certain other jurisdictions. Even so, in practice, appointed liquidators are licensed insolvency practitioners, accountants or other professionals with the requisite commercial experience.
In general terms, a court-appointed liquidator is required to investigate the affairs of the company in order to get in and realise its assets, before applying those realisations in discharge of the company’s liabilities, which will include investigating the conduct of the company’s past and present office holders to consider whether any wrongful conduct or criminal offence has been committed against the company.

In fulfilling these functions, liquidators have broad powers at their disposal, some that require sanction of the court or of a committee of inspection (if there is one) before being exercised (such as making any compromise or arrangement with the company’s creditors, contributories, claimants or debtors, and disclaiming onerous property); and some that do not (such as realising the property of the company and dealing with proofs of debt).

The committee of inspection is appointed at a meeting of creditors and is intended to be representative of the creditors of the company and capable of taking decisions in the interests of all creditors. Outside the powers only exercisable with sanction, it is for the liquidator to decide how frequently the committee of inspection is to be consulted. The Amendment Ordinance introduced a number of changes aimed at simplifying the proceedings of the committee of inspection and promoting court-free procedures, thereby potentially reducing the time and costs involved in the winding-up process.

iv Other restructuring methods

Workouts

Workout arrangements, pursuant to which a debtor company enters into contractual arrangements with its bank and other creditors, continue in Hong Kong and may be used in conjunction with a scheme of arrangement, as discussed below. The non-statutory guidelines issued jointly by the Hong Kong Association of Banks and the Hong Kong Monetary Authority provide principles as to how banks should deal with customers in financial difficulty, encouraging a standstill, during which an information gathering assessment can be undertaken with a view to reaching an informal decision as to the customer’s long-term future. Although non-statutory, banks are expected to adhere to the guidelines and to act cooperatively and in an expeditious manner in trying to agree a restructuring plan, and will be subject to scrutiny from the regulators if they fail to do so.

However, the guidelines are applicable only to banks and, therefore, other creditors such as bondholders, hedge funds, employees and trade creditors may proceed with enforcement actions during the period in which banks are seeking to implement a restructuring plan with the debtor company.

Scheme of arrangement

While a mechanism referred to as ‘provisional supervision’ was put forward by the government more than 15 years ago, Hong Kong continues to operate without a formal procedure by which a distressed company can reorganise its debt obligations and trade out of difficulties, such as administration in the UK or Chapter 11 in the United States.

The primary restructuring tool available, therefore, remains the scheme of arrangement, which can be used for both insolvent and solvent companies. Schemes may be used to supplement informal contractual workouts implemented by multibank creditor groups or other creditor constituencies.

As schemes of arrangement do not provide a statutory moratorium, there remains a risk of a creditor taking enforcement action, including winding-up proceedings, after a scheme of arrangement has been initiated. For this reason, schemes of arrangement in the
insolvency context are frequently undertaken in conjunction with provisional liquidation (where appropriate) or liquidation, to create the necessary moratorium. The *Legend* case confirmed that restructuring alone is not sufficient to found the appointment of provisional liquidators so that an applicant will still have to show concern as to, for example, potential dissipation of the company's assets and that it may reasonably be expected that liquidation will ultimately ensue. See Section III.

For a foreign company incorporated outside Hong Kong, whether it is possible to have provisional liquidators appointed in its jurisdiction of incorporation for the purpose of facilitating a corporate restructuring will depend on the law of that jurisdiction. If provisional liquidators are appointed to a foreign company where it was incorporated, and the provisional liquidators would like their appointment to be recognised in Hong Kong, they can obtain a letter of request from the court of the jurisdiction where they were appointed, and then apply to the Hong Kong court for an order to this effect.

If the company is being wound up, an application to court to convene a creditors' meeting to propound a scheme must be made by the liquidator or provisional liquidator. The court will consider whether the terms of the scheme are fair and could be supported by creditors exercising reasonable judgment. However, Hong Kong has not fully moved with the updated position in England so the court at the first hearing is not obliged to consider whether the classes of creditors involved in the scheme have been appropriately constituted. Therefore, there remains the risk of creditor classification being called into question at the second hearing, at which sanction is sought. The scheme will be legally binding on the company and the scheme creditors – including those scheme creditors who voted against the scheme and those who do not vote – if at the scheme meeting, the requisite majority representing a majority in number and at least 75 per cent in value of the creditors present and voting, in person or by proxy, at the meeting vote in favour of the scheme; the court sanctions the scheme; and an office copy of that order is registered by the registrar of companies in Hong Kong.

v Security

Hong Kong law recognises four forms of consensual security: the mortgage, the charge, the pledge and the lien. The formalities required for effective security, such as registration, will depend on the form of security. Failure to register a registrable charge will result in the charge being ineffective against a liquidator and any creditor of the company, although it will not affect the validity of the charge itself as between the parties to the security. Certain classes of assets (such as maritime vessels and aircraft) have separate registries, and registration will be required or expected at the relevant registry.

Secured creditors having a fixed charge will rank first for distributions from a company in liquidation. They are generally entitled to claim as unsecured creditors for any balance that remains unpaid after realisation of the security.

Where a company has granted a fixed and floating charge debenture (usually in favour of its bankers) over its undertaking, property and assets, the usual method of enforcement is through the appointment of a receiver. A receiver may be appointed outside liquidation but receivership is often indicative of insolvency. The validity of a floating charge created within 12 months if the person in favour of whom the floating charge is created is not connected

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5 *Re Legend International Resorts Ltd* [2006] 2 HKLRD 192.

6 *Joint Official Liquidators of A Co v. B Co* [2014] 4 HKLRD 374; and see Section IV.
with the company (or within two years if the person in favour of whom the floating charge is created is connected with the company) prior to the company’s winding up may be susceptible to challenge by the company’s liquidator to the extent that new monies were not advanced.

vi  Duties of directors

Directors’ duties (statutory and fiduciary) are owed to the company. While a company is solvent, the duty to act in the company’s best interests is generally assessed by reference to the interests of shareholders, whereas upon insolvency the interests of creditors will supersede those of shareholders in that assessment.

The codification of the duty of care, skill and diligence for directors now found in the Companies Ordinance is based on Section 174 of the UK Companies Act 2006 and therefore applies a dual objective/subjective standard to directors’ duty of care.

The Winding-Up Ordinance provides a summary method of enforcing existing duties owed by past and present officers (who include directors, managers and company secretaries) of a company subject to winding-up proceedings. Conduct that may give rise to liability under this section might include a breach of directors’ duties, or claims arising from preferences or fraudulent trading.

A liquidator is the agent of the company and on appointment displaces the directors and assumes their powers and functions in respect of the company. The directors remain obliged to assist the liquidator in the course of the winding up, and failure to provide the required assistance may result in civil and criminal penalties being imposed on the offending directors. In contrast, the liquidator does not owe duties to the directors of the company and is not required to keep the directors apprised of his or her activities.

vii  Clawback actions

As a starting point, there are two main categories of actions that a liquidator can bring:

a  company actions: The liquidator can commence proceedings in the name of the company to enforce rights and claims vested in the company prior to liquidation: the claim exists and can be pursued irrespective of whether or not the company is insolvent, and the proper plaintiff is the company; and

b  liquidator actions: In addition to company actions, there are a number of special powers given to a liquidator that can be invoked to avoid or reverse the effect of certain transactions that would have remained binding on the company but for its liquidation. These ‘avoidance powers’ are available only in the context of winding-up proceedings and are contained in legislation.

If a company is compulsorily wound up within one year of a payment out of capital under statutory procedures for redemption or buy-back of any of its own shares, the Amendment Ordinance now provides that directors who signed the solvency statement in relation to the payment out of capital and past shareholders will be jointly and severally liable to contribute to the assets of that company. It is a defence for a director to show that he or she had reasonable grounds for believing the opinion expressed in the solvency statement.

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7  Section 465, Companies Ordinance.
8  Section 276, Winding-Up Ordinance.
The Amendment Ordinance has updated Hong Kong’s antecedent breach legislation, including the introduction of undervalue transactions for corporate insolvency (the concept is well known but previously only applicable in personal bankruptcy). Pre-insolvency transactions that can be challenged or set aside by the liquidator include:

a transactions at an undervalue: Transactions entered into by a company for which the company received no consideration or consideration that is significantly less than that given by the company. A transaction at an undervalue will be liable to be set aside by a court unless the court is satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business, and at the time the company did so, there were reasonable grounds for believing that the transaction would benefit the company. The look-back period for transactions at an undervalue is five years;

b unfair preferences: Action taken by the company, influenced by a desire to prefer, that puts one creditor in a better position in the event of insolvency than it would otherwise have been. A transaction will be liable to be set aside by a court if there is evidence that the desire to prefer the recipient influenced the company’s decision to enter into the transaction (or make the subject payment) and if ‘it was one of the factors which operated on the minds of those who made the decision’. The desire to prefer the recipient does not have to be the dominant factor; it may simply be one of a number of matters considered by the company. Transactions involving a person connected with the company (other than by reason of being its employee) are presumed to be an unfair preference. The look-back period in respect of transactions entered into between an insolvent company and a person connected with the insolvent company (other than by reason of being its employee) is two years, and in any other case of an unfair preference, the look-back period is six months;

c extortionate extensions of credit to the company: The terms of the transaction are, or were, such as to require grossly exorbitant payments to be made or it otherwise grossly contravenes ordinary principles of fair dealing;

d floating charges: The Winding-Up Ordinance invalidates a charge created as a ‘floating charge’ within two years prior to the commencement of the winding up if the floating charge was granted to a person connected with the company (other than by reason of being its employee) or within one year prior to the commencement of the winding up if the floating charge was granted to any person other than a person connected with the company, provided that, in either case, the company subject to winding up was insolvent when the charge was created, or, alternatively, the company became insolvent as a consequence of granting the charge; and

e transactions made with the intention of defrauding creditors: The standard of proof is high and consequently it can be difficult to pursue this action.

viii Bank resolution regime

In the wake of the recent global financial crisis, the Financial Stability Board was tasked with developing a robust approach to allow systemically important financial institutions to fail safely.

Given Hong Kong’s status as an international financial centre and a Financial Stability Board member jurisdiction, the Financial Institutions (Resolution) Ordinance (FIRO)

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9 Re MC Bacon Ltd (No. 1) [1990] BCLC 324 at 336.
was enacted by the Legislative Council on 22 June 2016 and its commencement date was designated as 7 July 2017 (with the exception of certain provisions, requiring the finalisation of additional rules).

The FIRO is intended to establish a cross-financial sector resolution regime that is designed to strengthen the resilience of Hong Kong’s financial system and operates in the banking, insurance and securities and futures sectors.

The Hong Kong Monetary Authority (HKMA), the Insurance Authority and the Securities and Futures Commission are given powers as resolution authorities, including the powers to: impose a write-off or conversion of capital instruments issued by authorised institutions; resolve a holding company or group company of an entity within scope; and give effect to a resolution action taken by an overseas counterpart. Where a failing financial institution operates across more than one sector, one of the authorities will coordinate resolution as lead resolution authority.

Various stabilisation options are provided under the FIRO, which the relevant resolution authority can apply individually or in combination, broadly: transfer of the failing financial institution, or some or all of its business, to a commercial purchaser, a bridge institution or asset management vehicle; statutory bail-in; and, as a last resort, taking the institution into temporary public ownership (involving the use of public funds).

Where a resolution process is cross-border in nature, a key question is whether foreign jurisdictions will recognise each other’s resolutions. The FIRO provides for recognition to give effect to measures adopted by the foreign authority and supportive measures by the Hong Kong authorities to support the resolution action being taken by the foreign authority.

As a resolution authority under the FIRO, the HKMA published the ‘Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules’ (LACR Rules), which came into force on 14 December 2018. The LACR Rules aim towards limiting potential harm to the public as a result of the failure of a financial institution. In keeping in line with international standards set by the Financial Stability Board, the LACR Rules prescribe minimum loss-absorbing capacity requirements for authorised institutions and their group companies. The HKMA has further supplemented the LACR Rules with a Code of Practice, providing guidance to financial institutions on complying with the LACR Rules.

III RECENT LEGAL DEVELOPMENTS

Hong Kong is a gateway to business around Asia and investors continue to appreciate the certainty of its legal system and application of the rule of law. For a variety of reasons, including legal and tax considerations, enterprises running businesses through Hong Kong – whether listed in Hong Kong or not – will often do so using corporate structures involving several jurisdictions. In addition, the assets underpinning those businesses are frequently situated outside Hong Kong.

It is inevitable, therefore, that the continued global trend of cross-border insolvencies needs to be addressed in Hong Kong. Two associated aspects have been the subject of continued judicial consideration: jurisdiction of the Hong Kong courts to enable provisional liquidators appointed in Hong Kong to pursue restructurings and recognition of foreign liquidation proceedings. It should be noted that Hong Kong has not enacted the United

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Nations Commission on International Trade Law Model Law on Insolvency, so there is no statutory process for the formal recognition of foreign proceedings. Consequently, the courts must rely on common law principles and the ingenuity of practitioners.

### Restructuring powers of Hong Kong provisional liquidators

As noted above, schemes remain an important restructuring tool in Hong Kong but the absence of a statutory moratorium means that corporate debtors have frequently sought provisional liquidation to provide a stay on proceedings while a restructuring is mapped out through a proposed scheme.

However, the Hong Kong Court of Appeal’s 2006 decision in the liquidation of Legend International Resorts Limited\(^\text{12}\) caused some doubt on the role of provisional liquidators in restructurings in Hong Kong. In the words of Kwan J (as her Ladyship then was) in the subsequent case of *Re Plus Holdings Limited*,\(^\text{13}\) the *Legend* decision:

> held that the statutory power to appoint provisional liquidators under section 193 must be for the purposes of the winding up and that there is a significant difference between appointing provisional liquidators on the basis that the company is insolvent and assets are in jeopardy, which is permissible, and appointing provisional liquidators solely to facilitate a corporate rescue, which is not permissible.\(^\text{14}\)

It is only when ‘the purposes of the winding up’ exist that ‘there is no objection to extra powers being given to the provisional liquidator(s), for example those that would enable the presentation of an application under section 166 [of the old Companies Ordinance to propose and seek sanction of a scheme of arrangement]’.\(^\text{15}\) As Rogers VP pithily put it, ‘[t]he power of the court . . . is to appoint a [provisional] liquidator . . . for the purposes of the winding-up not for the purposes of avoiding the winding-up . . . Restructuring a company is an alternative to a winding-up’.\(^\text{16}\)

Since the Legend decision, the general view has been that Hong Kong law does not strictly allow ‘soft touch’ provisional liquidation to restructure a company.

### Z-Obee Holdings Limited

In *Z-Obee Holdings Limited*,\(^\text{17}\) a winding-up petition was initially presented in Hong Kong for the winding up of the company and on the same day, a summons was filed seeking the appointment of provisional liquidators. While provisional liquidators were initially appointed by the Companies Court so as to preserve the assets of the company, once those duties had been discharged, the primary matter remaining for consideration by the provisional liquidators was a potential restructuring of the company. Mindful of the potential limitations in Hong Kong, the provisional liquidators took steps to invoke the jurisdiction of the company’s place of incorporation (Bermuda), where provisional liquidators may be appointed, in appropriate circumstances, to facilitate a restructuring.

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\(^{12}\) [2006] 2 HKLRD 192.

\(^{13}\) [2007] 2 HKLRD 725.

\(^{14}\) Paragraph 7, *Plus Holdings*.

\(^{15}\) Paragraph 35, *Legend*.

\(^{16}\) Paragraph 36, *Legend*.

\(^{17}\) [2018] 1 HKLRD 165.

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The Hong Kong provisional liquidators were subsequently appointed as provisional liquidators by the Bermuda court and obtained recognition in Hong Kong by a letter of request in a procedure that is now well established in the Hong Kong Companies Court. The Hong Kong provisional liquidators were then discharged, the Hong Kong winding-up petition stayed and a restructuring of the company proceeded with the company having the protection of a statutory moratorium by reason of it being in provisional liquidation in Bermuda. This alternative process mitigated the risk that the Hong Kong court might proceed with the winding up of the company, which would preclude any restructuring. The schemes to implement the restructuring were then sanctioned by the courts of both Hong Kong and Bermuda and the shares of the restructured Hong Kong-listed company resumed trading.

**Changgang Dunxin Holdings Limited**

A similar scenario arose for Changgang Dunxin Holdings Limited, incorporated in the Cayman Islands. To address the potential limitations provided by Legend, the Hong Kong-appointed provisional liquidators sought their appointment as Cayman provisional liquidators to enable them to exercise the broader restructuring powers more clearly available in that jurisdiction.

This proposal was sanctioned by the Hong Kong court, leading to: an application for common law recognition of the Hong Kong provisional liquidators’ powers as foreign liquidators to act in the name and on behalf of the company for the limited purpose of making an application to wind it up in the Cayman Islands and to be appointed as Cayman provisional liquidators; following recognition being granted in the Cayman Islands, the presentation of a winding up petition in the Cayman Islands and the issue of an application for the appointment of the Hong Kong provisional liquidators as Cayman provisional liquidators; with a subsequent discharge of the Hong Kong provisional liquidators and their Cayman appointment recognised in Hong Kong, the Cayman provisional liquidators will then be able to undertake the proposed preparation and promotion of parallel schemes of arrangement in the Cayman Islands and Hong Kong.

It was not clear whether common law recognition could be used to permit foreign insolvency representatives (i.e., appointed somewhere other than the place of incorporation of the company) to present a petition to wind up a company in its place of incorporation and seek their own appointment as provisional liquidators. In *Singularis Holdings Ltd v. PwC*,18 the Privy Council held that liquidators appointed in the Cayman Islands (the place of incorporation) could not be treated as if they had been appointed in Bermuda, where the relevant statutory power was broader: the Supreme Court of Bermuda could only provide assistance if the Cayman Court could make the equivalent order. By contrast, Changgang’s Hong Kong provisional liquidators were seeking to bring the proceedings back to the place of incorporation and to be appointed provisional liquidators in the Cayman Islands; and were not seeking ‘as if’ recognition. Therefore, the restrictions set out in *Singularis* were not applicable to their application.

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18 [2014] UKPC 36.
China Solar Energy Holdings Limited

In Re China Solar, the Hong Kong Companies Court (at first instance) has determined that where warranted by the circumstances, provisional liquidators may be given restructuring powers and pursue the restructuring through to completion, clarifying the position post-Legend.

Provisional liquidators were appointed to China Solar Energy Holdings Limited (China Solar), a Bermuda-incorporated, Hong Kong-listed company, on the basis that provisional liquidators were needed to safeguard the company’s assets and to investigate transactions entered into by the company. Their powers on appointment included an ability to pursue a restructuring.

A creditor later issued a summons for, inter alia, the winding up of the company and the discharge of the provisional liquidators, arguing that because they had finished their asset preservation role the primary remaining focus would be the company’s restructuring, which should be impermissible as a result of the Legend decision.

In dismissing the application, the companies judge confirmed that provisional liquidators should not be appointed for the sole purpose of restructuring; however, provisional liquidators may be given restructuring powers in appropriate circumstances and should be permitted to complete the restructuring, even if they have completed asset preservation and other tasks. Termination of their office because restructuring is the remaining primary task would be inconsistent with the statutory purpose underlying their appointment.

In two subsequent cases, the companies judge reaffirmed his decision in Re China Solar by granting restructuring powers to the provisional liquidators when considered appropriate. In Re CW Advanced Technologies Ltd, the judge noted at Paragraph 27:

The terms of the order of appointment here does not confer on the provisional liquidators any powers to pursue debt restructuring. This is not to say that they may not apply for an extension of their powers in future. It is well established that where the circumstances warrant the appointment of provisional liquidators, the provisional liquidators may be granted powers to explore and facilitate a debt restructuring. Of course whether such powers should be granted and the scope of the powers would depend on the particular circumstances such as the existence of creditor support.

In Hsin Chong Group Holdings Ltd, at Paragraph 9:

The powers in sub-paras 2(i)–2(vi) of the order sought are not in the standard order and are required for the purposes of the restructuring. They are specifically requested in the letter of request. For the reasons explained in my decision in Re China Solar Energy Holdings Ltd (No 2) it is not permissible to appoint provisional liquidators in Hong Kong in order to restructure the debt of the company. It is, and I summarise, permissible to appoint provisional liquidators for orthodox reasons and, after the provisional liquidators have familiarised themselves with the affairs of the company, for an interested party (commonly the provisional liquidators) to apply to court if it is thought desirable for restructuring powers to be granted to the provisional liquidators. It is not in my opinion inconsistent with Hong Kong law for restructuring powers to be granted by way of assistance to a provisional

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20 See footnote 12.
liquidator appointed over a foreign company by the court of its place of incorporation, in which a
soft-touch provisional liquidation is permissible, as such powers can be granted, albeit in the more
limited circumstances discussed in China Solar, to a Hong Kong provisional liquidator.

While the place of incorporation is frequently considered the appropriate forum for the
winding up of a company, many Caribbean-incorporated companies are registered in Hong
Kong with listings, creditors and assets there, and it seems that the Hong Kong provisional
liquidation regime can continue to aid such companies achieve a restructuring without the
need for recognizable contortions.

ii Recognition of foreign proceedings

In *Singularis*, the Privy Council Board considered the doctrine of modified universalism
(wherby, broadly speaking, a court will give such assistance as it can to foreign insolvency
proceedings, consistent with local law and local public policy, to ensure that a company's
assets are distributed under a single system), and held by a majority that there was a common
law power to assist a foreign insolvency, although the power could not be used to enable
foreign liquidators to do something that they could not do under the law of the liquidation
under which they were appointed. The application of such a power has resonated with similar
common law jurisdictions globally.

Common law assistance in Hong Kong

In Hong Kong, foreign liquidators seeking assistance from Hong Kong courts previously
would wind up the company in Hong Kong to avail themselves of the statutory powers as local
to Cayman liquidators pursuant to a letter of request from the Cayman Court, that the
authority of a liquidator appointed under the law of a company's place of incorporation
should be recognised in Hong Kong. It is now broadly established that a recipient, such as a
bank, of a request from a foreign liquidator would be expected to respond as if the request
were from a director of that company, rather than requiring a Hong Kong court order before
releasing information requested. However, a distinction is to be made with regard to assets,
where the judge indicated that a foreign liquidator would need to apply for an order vesting
him or her with title to the local property.

Where a UK administrator sought assistance from the Hong Kong court in recognising
the moratorium created by the administration order in the UK to prevent disposal of the
company's assets, the court concluded that it could not provide the assistance because to do
so would be an impermissible extension of common law principles: Hong Kong currently has
no procedure analogous to administration in the UK, with a moratorium on the enforcement
of secured debt, and thus the order was not one that would be available to a Hong Kong office
holder.

23 See footnote 18.
25 ibid at Paragraph 6.
26 *The Joint Administrators of African Minerals Ltd (in administration) v. Madison Pacific Trust Ltd and
Shandong Steel Hong Kong Zengli Limited* [2015] HKEC 608.
In BJB Career Educational Co Ltd (in provisional liquidation) v. Xu Zhendong, the court noted that:

in the exercise of its common law powers the Hong Kong Companies Court can order the oral examination of a director of a Cayman Island company in liquidation in the Cayman Islands if satisfied that it is necessary and that it would not infringe the established limitations on the exercise of the power conferred by section 221 [of the Winding-Up Ordinance].

That common law power did not contravene Article 96 of the Basic Law, which provides: 'With the assistance or authorisation of the Central People’s Government, the Government of the Hong Kong Special Administrative Region may make appropriate arrangements with foreign states for reciprocal juridical assistance.' The approach in BJB was also followed in Re Pacific Andes Enterprises (BVI) Ltd.

The Companies Court reiterated its view in Bay Capital Asia that banks should give assistance to foreign liquidators seeking information on receipt of a letter of request, albeit without a Hong Kong court order, having satisfied themselves that the liquidators have been appointed by the court of the place of the company's incorporation.

The Hong Kong court’s power to recognise and grant assistance to foreign insolvency proceedings and foreign insolvency office-holders is founded singularly on common law principles. Therefore, the scope of, and the Hong Kong court’s ability to grant, such recognition and assistance is limited by principles set out in case law.

These limitations include, broadly: (1) in order for a power, remedy or relief to be exercisable by or available to a Hong Kong court, it must exist in both the jurisdiction of liquidation and the assisting jurisdiction; (2) a Hong Kong court may grant assistance in winding up proceedings provided that the foreign liquidation is collective in nature, specifically if it is ‘a process of collective enforcement of debts for the benefit of the general body of creditors’; this means, for example, that judicial assistance will not be given to a solvent liquidation; (3) a Hong Kong court may assess a power as being vested in the foreign insolvency office-holder only when it is necessary for the performance of the office-holder’s functions.

27 ibid at Paragraph 7.
29 [2017] HKEC 146.
30 Bay Capital Asia LP v. DBS Bank (Hong Kong) Ltd [2016] HKEC 2377.
31 Singularis. The basis for this view has traditionally referred to the jurisdiction of the place of incorporation of the relevant company, but the Hong Kong court in African Minerals noted the possibility of extending the principle to include a jurisdiction that is not the place of incorporation, but in which the liquidation has been granted.
34 In Supreme Tycoon, the Hong Kong court simply refers to a foreign insolvency office-holder irrespective of whether such office-holder is an officer of the foreign court. This is wider than the meaning in Singularis where the Privy Council refers to ‘officers of a foreign court of insolvency jurisdiction or equivalent public officers’. The difference means that a Hong Kong court would likely recognise and assist insolvency practitioners who are not appointed by a court while courts who follow the dicta of the Privy Council in Singularis would likely only assist and recognise court appointed insolvency practitioners.
Recognition of voluntary liquidations

In a precedent-setting decision, the Hong Kong Court of First Instance granted a recognition order in favour of foreign liquidators appointed in an insolvent liquidation commenced by a shareholders’ resolution. In so recognising the foreign liquidators, the Court confirmed that its exercise of the common law power of assistance extends to foreign insolvent voluntary windings up, an issue that has been in doubt following the obiter dicta views expressed by Lord Sumption in the widely cited Singularis decision.

In reaching this decision, the judge made the observation that ‘what matters for cross-border insolvency assistance is not whether the foreign insolvency officeholder is or is not an officer of the foreign court. What matters is whether the foreign proceeding is collective in nature, in the sense that it is ‘a process of collective enforcement of debts for the benefit of the general body of creditors’[2] Re Lines Bros Ltd [1983] Ch 1, 20. It is with collective insolvency proceedings that the principle of modified universalism is concerned[3] Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings [2007] 1 AC 508. The judge, therefore, concluded that recognition should not be provided to liquidators appointed in a foreign solvent liquidation on the basis that it is not a collective insolvency proceeding but rather ‘more akin to the “private arrangement” the Privy Council was referring to [in Singularis][4] [2015] AC 1675 at [25]’.

This approach is consistent with the principle of modified universalism, the rationale underlying the common law power of assistance and the means by which, absent being a party to the UNCITRAL Model Law on Cross-Border Insolvency, the Hong Kong Companies Court is able to recognise and grant assistance to foreign insolvency proceedings.

The continued line of decisions shows that to the extent established common law principles require the Hong Kong court to recognise foreign liquidators, it is both prepared and willing to provide assistance to them in appropriate circumstances.

Scheme moratoria

In the recent case of Re CW Advanced Technologies Limited, the Hong Kong court took the opportunity, albeit only obiter dicta, to raise and briefly comment on certain unresolved questions surrounding three issues of interest to insolvency practitioners: first, whether a scheme moratorium ordered by a Singapore court under Singapore law can qualify for common law recognition in Hong Kong; and if yes, second, whether the Hong Kong court may grant assistance by appointing provisional liquidators; and third, whether a scheme of arrangement in general can be characterised as a ‘collective insolvency proceeding’ under Hong Kong law.

Section 211B of the Singapore Companies Act sets out a clear two-step scheme moratorium system, comprising (1) an initial automatic moratorium under Section 211B(8)(e) of the Companies Act; and (2) a subsequent moratorium applied for by the scheme company and potentially granted by the Singapore court under Section 211B(1) of the Companies Act.

35 Re Supreme Tycoon Limited.
36 [2015] AC 1675 at [25].
37 This view diverges from that expressed by the Singapore High Court in Re Gulf Pacific Shipping Ltd [2006] SGHC 287, which relied on a US Bankruptcy Court of Nevada decision concerning recognition of an Australian members’ voluntary liquidation under Chapter 15 of the US Bankruptcy Code.
38 [2018] HKCFI 1705.
While the 30-day automatic moratorium provision under Singapore law could arguably embrace concepts accepted under Hong Kong insolvency law, its restriction on enforcement of security under Section 211B(8)(e) finds no parallel in Hong Kong law. Further, Hong Kong law does not recognise a moratorium or stay of proceedings against a company while such proposed scheme is being put together, or currently have any equivalent to administration with a corresponding statutory provision providing for a moratorium on the enforcement of secured debt, although in limited circumstances an injunction could be sought by a party in order to restrain an enforcement of security.

Accordingly, the application of the incorporation/assisting jurisdiction availability principle could potentially stand in the way of recognition of an order containing a security enforcement restriction that is sought in Hong Kong for a Singapore scheme moratorium.

The court in Re CW Advanced Technologies Limited indicated the possibility of recognition of a Singapore moratorium in Hong Kong by generally characterising a scheme of arrangement (of which the scheme moratorium under Singapore law forms a part) as a ‘collective insolvency proceeding’. By placing a scheme of arrangement under the umbrella of this legal concept in Hong Kong law, recognition could theoretically be achieved via inclusion of the moratorium within the scope of the collective insolvency proceeding, which could be recognised under Hong Kong law.

In raising the issue, the court referred to a number of different sources of analysis, such as Chapter 15 of the US Bankruptcy Code, Section 426 of the UK Insolvency Act 1986 and English authorities reviewing Regulation (EU) No. 1215/2012, but without proffering a conclusion. However, the court suggested that the doctrine of modified universalism would not preclude recognition in those circumstances and noted the Singapore and Cayman authorities purportedly supporting that conclusion.

However, a scheme of arrangement is a statutory procedure which allows a company to reach an arrangement or compromise with its members or creditors (or any class of them) and is not limited to the insolvency context. A scheme outside insolvency proceedings would not fall under the definition of collective insolvency proceedings since it is not ‘a collective enforcement of debts for the benefit of the general body of creditors’, similar to Harris J’s observations about voluntary liquidations in Supreme Tycoon.

Should it be determined that a scheme of arrangement in the insolvency context is to be classified as a collective insolvency proceeding, a statutory limit or restriction should be created to ensure confusion is avoided as to how the concept is applied.

It seems a scheme put in place after the opening of an insolvency proceeding could more easily qualify as a collective insolvency proceeding and indeed facilitate recognition in Hong Kong. It also seems arguable that it is the insolvency proceeding rather than the scheme which constitutes the ‘collective enforcement of debt’, and that the scheme is merely

39 Credit Lyonnais v. SK Global Hong Kong Ltd [2003] 4 HKC 104 and Joint Administrators of African Minerals Ltd v. Madison Pacific Trust Ltd [2015] 4 HKC 215. At Paragraph 10 of SK Global, the Hong Kong Court of Appeal noted that ‘[i]t is not up to the court to use its inherent jurisdiction to create a regime in which a judgment creditor or insolvent company is able to obtain a moratorium on its debts (or to put it more crudely, to give it some “breathing space” to allow it to negotiate with creditors).’


41 Re Opti-Medix Ltd [2016] SGHC 108; Re China Agrotech Holdings Ltd (Cayman Grand Court, 19 September 2017)

42 See, for example, Re Rodenstock GmbH [2011] EWHC 1004.
a means to implement the enforcement efficiently. In that event, the analysis might return to conventional lines: are the foreign office-holders entitled to recognition (rather than being a question of whether the statutory scheme moratorium is eligible for recognition).

It therefore seems that there is room for recognition under available common law principles for recognition in Hong Kong of a Singapore moratorium (1) as long as the order for such moratorium does not include a stay on enforcement of security; (2) as long as the scheme of arrangement qualifies as a collective insolvency proceeding; and (3) if the court can recognise a foreign collective insolvency proceeding in a jurisdiction that is not that of the debtor's incorporation following the modified universalism doctrine.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

i Listing resumptions

In Hong Kong, successful restructurings have often involved the resumption in trading of shares of Hong Kong listed companies in provisional liquidation, where broadly an investor has been willing to inject capital and, where appropriate, assets in exchange for shares in the company, subject to regulatory approvals and ultimately confirmation of the intended resumption.

In *China Solar*, the companies judge noted that '[m]any authorities have referred to a company's listing status as the company's asset, although they have not considered in any detail a listing status' legal attributes and character.'* That asset may be the primary one available to enable any meaningful restructuring to generate recovery for creditors.

A consultation paper (Consultation Paper) was issued by the Hong Kong stock exchange (Exchange) in June 2018 seeking to address the Exchange's concern 'to curtail the injection of ineligible new business into listed shells through backdoor listings without restricting legitimate business expansion or diversification'. Many of the proposals in the Consultation Paper are codifications of current practice and previous guidance. The consultation period closed on 31 August 2018 and the Exchange plans to publish its conclusions in 2019.

Listing Rule 14.06(6) applies to treat as a reverse takeover an acquisition, or series of acquisitions, of assets which in the Exchange's opinion constitutes an attempt to effect a listing of the assets whilst circumventing the requirements for new applicants under the Listing Rules. The Exchange considers certain criteria when deciding whether a proposed transaction would involve an unacceptable circumvention. A listed issuer proposing a reverse takeover will generally be treated as if it were a new listing applicant: under the existing rules the enlarged group or the assets to be acquired must meet the track record requirements for new applicants and the enlarged group must meet all other new listing requirements under Chapter 8 of the Listing Rules.46

43 [2018] HKCFI 555, at Paragraph 39(5)
45 Consultation Paper on Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments
46 See Listing Rule 14.54.
Currently an issuer must carry on a sufficient level of operations or have sufficient assets to warrant the continued listing of its shares. An issuer that does not meet this requirement is normally suspended. The Consultation Paper outlines a number of proposals for amendment to the relevant Listing Rules, including proposals: (1) to amend Listing Rule 14.54 and add a new rule to require that both the acquisition targets and the enlarged group must meet the suitability requirements under Rule 8.04; and the acquisition targets must meet the track record requirements under Rule 8.05 and the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Rules; and (2) to amend Rule 14.54 to require that where an issuer that has failed to comply with the sufficiency of operations/assets requirement proposes a reverse takeover, each of the acquisition targets and the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Rules.

In distressed resumption proposals, the listed issuer often has insufficient operations and intends to acquire a profitable business through a very substantial acquisition constituting a reverse takeover, while currently the target must comply with the three-year profits requirement for a new listing application (so that, in effect, the injection is not a circumvention of the new listing requirements). The impact of the proposed changes to Listing Rules 13.24 and 14.54 appear to make it difficult for such a reverse takeover to be viable if the distressed listed company made a loss in any of the previous three years.

ii Gibbs principle

A foreign compromise does not necessarily discharge a debt unless it is discharged under the law governing the debt. In a creditors' scheme purporting to vary contractual rights, the effectiveness of the scheme may require that the debtor seeks not only the sanction of the court in its jurisdiction of incorporation but also of the courts in the jurisdictions that govern its contractual debt obligations, to ensure that dissenting creditors cannot enforce their claims against the debtor company in jurisdictions other than that of its incorporation.

Recent examples of schemes are becoming increasingly cross-border in nature given the mix of creditor constituencies involving bank debt as well as bonds subject to, for example, New York law. The result increasingly requires parallel schemes in Hong Kong, the relevant offshore jurisdiction (such as Bermuda, the Cayman Islands or British Virgin Islands, where companies listed in Hong Kong are frequently incorporated) together with Chapter 15 recognition in the United States, with a view to ensuring that claims in all relevant jurisdictions are extinguished.

A typical restructuring in Hong Kong will involve an offshore, Hong Kong-listed entity with debt governed by offshore law (for example New York law), as demonstrated by the scheme cases above. It is not uncommon to see that the law governing a loan document is different from that of the debtor company's place of incorporation. The recent IBA case before the English courts has brought back under the spotlight the Gibbs principle, which broadly provides that a debt governed by English law cannot be discharged or compromised by a foreign insolvency proceeding.

48 Consultation Paper, Paragraph 69.
49 See Re Drax Holdings Ltd [2004] 1 WLR 1049.
51 Antony Gibbs & Sons v. La Société Industrielle et Commerciale des Métaux (1890) LR 25 QBD 399.
Singapore appears to have declined to follow the *Gibbs* principle, but it is applied in Hong Kong, where it remains the case that (broadly): (1) a debt governed by Hong Kong law cannot be discharged or compromised by a foreign insolvency proceeding unless, broadly, the relevant creditor submits to the foreign insolvency proceeding; and (2) Hong Kong creditors’ rights under Hong Kong law-governed debt can only be compromised in a Hong Kong law-governed process. The use of a parallel scheme of arrangement in Hong Kong – although adding to the cost of the restructuring process – alongside the foreign proceeding would likely overcome the concern of ‘outlier’ creditors.

In certain restructurings, such as of *LDK Solar Co Ltd* and *Z-Obee*, debts dealt with by the Hong Kong schemes were at least in part governed by Hong Kong law. This generally assists in satisfying the ‘sufficient connection’ test when the court considers sanction of a Hong Kong scheme for a foreign-incorporated company and also alleviates the potential concern that a scheme compromising purely foreign-law debt would be inconsistent with the common law rule in *Gibbs* that a foreign composition does not discharge a debt unless it is discharged under the law governing the debt.

In *Winsway*, the debt subject to the Hong Kong scheme of arrangement was governed exclusively by New York law. However, the law governing the debt was not the only factor to be taken into account when considering a sufficient connection with Hong Kong. Further, regardless of the governing law of the debt, the Hong Kong scheme would prevent a dissident creditor taking action within the jurisdiction of the Hong Kong courts: one of the principal reasons for proposing a scheme in Hong Kong. The court was also satisfied that the purpose of the scheme was likely to be achieved, as Chapter 15 recognition was likely to be granted in respect of the New York law-governed bonds, and, therefore, the Hong Kong court sanctioned the Hong Kong scheme, compromising debt governed exclusively by foreign law.

**V INTERNATIONAL**

i **UNCITRAL Model Law**

The United Nations Commission on International Trade Law (UNCITRAL) adopted the Model Law in light of the increasing incidence of cross-border insolvencies; and because national insolvency laws were recognised to have limited provision for cases of a cross-border nature, resulting in inconsistent legal approaches.

Currently, there is no statutory provision empowering a Hong Kong court to render assistance to a foreign court in an insolvency matter, as Hong Kong has not adopted the Model Law in its domestic legislation, or any other legislation to similar effect (except with regard to certain aspects of arbitration).

The UNCITRAL Model Law recognises the continued differences among national procedural laws and instead of attempting the unification of substantive insolvency law, focuses on encouraging cooperation and coordination between jurisdictions. Its adoption (or incorporation of similar concepts in domestic law) would therefore be only a first step, and

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53 *Re LDK Solar Co Ltd* [2014] HKCU 2855.
54 [2018] 1 HKLRD 165 at Paragraph 17.
the sorts of issue raised in the *CW Advanced Technologies* case, for example, would remain to be addressed under the common law, if not specifically addressed through additional legislative provisions.

ii The Hong Kong courts’ approach

The approach taken by the Hong Kong courts to cross-border insolvencies has been pragmatic. There is increasing acknowledgement of the need for courts from different jurisdictions to assist one another where possible and to address the common law recognition of foreign liquidators (see Section III).

The Hong Kong courts have a broad jurisdiction to wind up companies in Hong Kong. This extends not only to companies that are incorporated in Hong Kong, but also to overseas companies registered in Hong Kong and unregistered companies, providing certain requirements are met.

In the *Lehman Brothers* liquidations, where there are a number of office holders in different countries, the Hong Kong liquidators of certain key affiliates were instrumental in implementing a cross-border protocol for dealing with information sharing and creditor resolution proposals.

The continued line of decisions shows that to the extent established common law principles require the Hong Kong court to recognise foreign liquidators, it is both prepared and willing to provide assistance to them in appropriate circumstances. However, the court in *CW Advanced Technologies* also raised a perceived need for a statutory cross-border insolvency regime in Hong Kong.

VI FUTURE DEVELOPMENTS

i Corporate rescue procedure

The Hong Kong Financial Services and the Treasury Bureau (FSTB) indicated that their target was to table a bill to the Legislative Council in 2018 for the introduction of a statutory corporate rescue procedure and insolvent trading provisions, but the position remains uncertain.

ii Reciprocal judgment recognition

The FSTB published a consultation paper on a potential reciprocal judgment regime between China and Hong Kong, including reciprocity in insolvency law. A primary difficulty is the jurisdictional barrier between the two regions, preventing Hong Kong-appointed provisional liquidators from pursuing assets in the Mainland.

The FSTB recognised the growing necessity and urgency of a reciprocal recognition regime for insolvency matters – this was echoed by the Hong Kong Institute of Certified Public Accounts and the Hong Kong Law Society.

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56 See Section III – Scheme Moratoria.
I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

The key legislation governing insolvency in India is the Insolvency and Bankruptcy Code 2016 (IBC), which deals with insolvency and liquidation of corporate persons (i.e., companies, limited liability partnerships and any other person incorporated with limited liability) and bankruptcy of individuals and partnership firms. In terms of informal work-out arrangements, the Reserve Bank of India (RBI), the banking and foreign exchange regulator, issued a prudential framework for the resolution of stressed assets on 7 June 2019 (the RBI Circular), which contemplates implementation of a resolution plan through an inter-creditor arrangement (ICA) in relation to stressed assets.2

As of March 2019, 1,800 corporate debtors have been admitted to the corporate insolvency resolution process (CIRP) and out of these about 1,143 cases are outstanding. Resolution plans for 94 stressed assets were approved by the National Company Law Tribunal (NCLT) wherein the recovery has been 43 per cent of admitted claims (i.e., about 750 billion rupees have been recovered against claims of 1,750 billion rupees). The IBC states that the CIRP should be completed within a maximum period of 270 days (including an extension of 90 days); however, meeting the prescribed timelines has proven to be a challenge and about 362 cases have exceeded the 270-day period as a result of various issues including legal challenges. The banking sector gross non-performing asset (NPA) has reduced to about 10 per cent.3 The average recovery through the IBC is significantly better than through other recovery and work-out mechanisms.4

As a result of the IBC, the market for pre insolvency work outs and restructuring has also been very active, which has, among others, resulted in increased securitisation

1 Piyush Mishra is a partner at AZB & Partners. The author would like to acknowledge the contribution of Ms Nikita Sinha, a senior associate, and Ms Karishma Singh, an associate, at AZB & Partners.

2 The RBI circular dated 12 February 2018 also provided for mandatory reference to insolvency in the event of failure to restructure within a stipulated time line for certain large accounts. However, the circular was set aside by the Supreme Court in the Dharani Sugars Mills case (Civil Original/Appellate Jurisdiction Transferred Case (Civil) No. 66 of 2018 in Transfer Petition (Civil) No. 1399 of 2018, judgment dated 2 April 2019).

3 For data in this paragraph please see, Insolvency and Bankruptcy Board of India, Insolvency and Bankruptcy News, Vol 10, p. 13 (January–March 2019); CRISIL and ASSOCHAM, Strengthening the Code, p. 7 (May 2019).

and secondary trading of debt. It has been said that over 2,800 billion rupees of debt were addressed even before admission into the IBC, as the borrowers settled the defaulted amounts with the lenders.\(^5\)

In terms of liquidity, owing to elections and limited government spending there is a higher liquidity deficit than usual. In particular, the non-banking financial sector is witnessing a liquidity crunch because of issues on asset liability mismatch in some large financial entities. However, the government and the RBI are proactively managing the liquidity in the system and dollar swaps may be helpful in this respect.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

The IBC, together with the rules and regulations made thereunder, is a complete code that deals with both insolvency resolution and liquidation process. Currently only the rules and regulations dealing with corporate persons are in effect. Compromise and arrangements with creditors is also possible under Section 230 of the Companies Act 2013.

The Insolvency and Bankruptcy Board of India (IBBI) is the regulator established under the IBC for its implementation. The NCLT is the adjudicating authority in respect of CIRP and liquidation.

Some of the key features of the IBC CIRP framework are noted below:

- A creditor (Indian, foreign, secured, unsecured, financial, operational) can trigger the insolvency resolution process in respect of a corporate debtor if the default exceeds 100,000 rupees by filing an application with relevant NCLT establishing default and proposing an interim resolution professional (IRP). A corporate debtor can also make an application for initiation of insolvency resolution process against itself, provided that relevant corporate compliances, including a shareholders resolution has been passed by requisite majority.

- Once admitted, a moratorium (including in relation to suits, transfer of assets and enforcement of security) comes into effect in respect of the corporate debtor from the insolvency commencement date.

- The board of directors is suspended and the IRP takes control of the corporate debtor and its assets. It also invites creditors to submit proof of claims in the prescribed format through a public notice.

- Based on verification of proof of claims, the committee of creditors (COC) consisting of financial creditors is constituted by the IRP.\(^6\) Certain decisions require COC approval by majority or 66 per cent super majority (such as approval of a resolution plan and confirmation of the IRP as resolution professional (RP)).

- In addition to running the day-to-day operation of the corporate debtor, conducting COC meetings and filing the progress reports with NCLT, the RP also appoints a registered valuer to assess liquidation and fair market value of the corporate debtor,

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6 In certain instances where a corporate debtor has no financial debt or where all financial creditors are related parties of the corporate debtor, the COC will consist of operational creditors and representatives of workmen and employees.
engages various consultants to (1) conduct a transaction audit in respect of antecedent transactions; (2) advise on the resolution process; and (3) ascertain if the resolution applicants are ineligible to submit a bid under the IBC.

RP publishes an invitation for expression of interest and persons who meet the criteria are invited to submit a resolution plan.

Certain persons are not eligible to submit a resolution plan or to participate in liquidation of the corporate debtor. The ineligibility conditions are fairly detailed and include items such as (1) a wilful defaulter; (2) where an account of a corporate debtor under the management of control of such person or where such person is a promoter is classified as an NPA for at least one year (unless all amounts are paid before submission of the resolution plan); (3) the person is disqualified to act as director under the Companies Act 2013; and (4) has a ‘connected person’ who is not eligible to submit a resolution plan. There are certain exemptions for financial entities.

A legally compliant resolution plan approved by the COC with requisite majority is filed with the relevant NCLT for approval.

If no resolution plan is received or if a resolution plan is not approved by COC, the corporate debtor automatically goes into liquidation.

IBC deals with both voluntary liquidations and those pursuant to insolvency. Some of the key features of the liquidation framework pursuant to insolvency under the IBC are noted below.

Pursuant to the liquidation order by the NCLT, the COC is dissolved and a liquidator is appointed by the NCLT, who acts in a quasi-judicial capacity and reports to the NCLT.

The liquidator is responsible for (1) verifying claims of all creditors; (2) taking custody and control of all assets of the corporate debtor; (3) preparing an asset memorandum in relation to liquidation estate; and (4) appointing two registered valuers for valuation of assets.

The liquidator may sell the assets of the corporate debtor collectively or on a standalone basis or in parcels or by slump sale. He may also sell the corporate debtor (or any of its business) as a going concern. Sale is typically through auction.

The liquidator has to file a quarterly progress report; upon sale of an asset, an asset sale report; and a final report prior to dissolution with the NCLT.

The liquidation process has to be completed in two years (Regulation 44).

IBC provides for a claw-back period of two years from the insolvency commencement date if the transactions are entered into with related parties, or a period of one year in all other cases. If any transactions are found to be preferential, undervalued, extortionate or undertaken to defraud creditors, the resolution professional or liquidator should file an avoidance application before the NCLT for appropriate relief, including for the transaction to be set aside.8

7 ‘Connected person’ is defined under Section 29A of the IBC, and includes a person who is a promoter or is in management or control of the resolution applicant or corporate debtor (during implementation of the resolution plan) or is a related party of such person.

8 In IDBI Bank Ltd. v. Jaypee Infratech Ltd, C.A. No. 26 of 2018 certain securities were set aside pursuant to the relevant provisions of IBC.
Directors of companies act in a fiduciary capacity and have a duty to exercise due and reasonable care and exercise independent judgement. The IBC also deals with wrongful and fraudulent trading. In such cases, the NCLT may, upon application by RP, order a director to make contributions to the assets of the corporate debtor if such director knew or ought to have known that there was no reasonable prospect of avoiding commencement of CIRP in respect of the corporate debtor and did not exercise due diligence to minimise potential loss to the creditors of the corporate debtor.9

The IBC provides for stringent penalties (imprisonment or fines) for breach of its provisions. In relation to certain offences committed by an officer of the corporate debtor, the penalty prescribed10 is imprisonment for a term of not less than three years and up to five years, or with fine not less than 100,000 rupees and up to 10 million rupees or both. Further, (1) where an officer of the corporate debtor enters into any transaction for defrauding creditors (within a period of five years from the insolvency commencement date); or (2) where any corporate debtor, its officers or creditor or any person on whom the resolution plan is binding, knowingly and wilfully contravenes any term of the resolution plan (or abets such contravention) such person shall be liable for imprisonment for a term of not less than one year and up to five years, or with a fine of not less than 100,000 rupees and up to 10 million rupees or both. Any person who destroys, mutilates, alters or falsifies any books or records of the corporate debtor with the intent to defraud any person is punishable with imprisonment for a term of not less than three years and up to five years, or with fine of not less than 100,000 rupees and up to 10 million rupees or both.

The government and the regulators (RBI, IBBI, Securities and Exchange Board of India (SEBI)) have been very proactive in addressing various issues through changes to IBC and relevant regulations. In the context of listed companies, various exemptions have been provided by SEBI to a resolution applicant under applicable regulations. These include the following:

a. exemption from making an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011;

b. exemption under pricing guidelines in relation to preferential allotment under SEBI (Issue of Capital and Disclosure Requirement) Regulations 2011;

c. shareholders’ consent is not required for reclassification of promoter, related party transactions and certain transactions involving material subsidiaries under SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015; and

d. SEBI (Delisting of Equity Shares) Regulations 2009 have also been simplified, relaxing the approval requirement and allowing relisting.

RBI has also permitted:

a. any entity which is under restructuring scheme/corporate insolvency resolution process under the IBC to raise external commercial borrowing (ECBs) if specifically permitted under the resolution plan.

b. raising ECBs from recognised lenders (except branches / overseas subsidiaries of Indian banks) under the approval route for repayment of rupee term loans of such entities (which is otherwise a restricted end-use under the current ECB regime in India).

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9 Section 166 of Companies Act and Section 66 of IBC.

10 Concealment of property (Section 68), misconduct in the course of CIRP (Section 70), wilful or material omissions from statements relating to affairs of the corporate debtor (Section 72), false representations to creditors (Section 73), violation of moratorium (Section 74).

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In terms of informal work-out arrangements, the banks have been given broad powers under the RBI Circular to restructure the account; seek a change in ownership; sell exposure to other entities or investors; or to regularise the account through payment of all overdue amounts by the borrower. Lenders are required to undertake a review of the account within 30 days of default (the review period) and decide on a resolution strategy. The ICA has to be entered into within the review period. Any decision agreed to by lenders representing 75 per cent by value of total outstanding credit facilities and 60 per cent of lenders by number is binding on all lenders. The resolution plan must provide for payment of no less than the liquidation value\textsuperscript{11} due to the dissenting lenders. The resolution plan should be implemented within 180 days from the end of review period. In the event a viable resolution plan is not implemented within (1) 180 days from the end of the review period, an additional provision of 20 per cent of the outstanding total will be required; and (2) 365 days from the commencement of the review period, additional provision of 15 per cent of the outstanding total is required (i.e., an additional 35 per cent). These additional provisioning requirements are in addition to provisions already held or required as per asset classification status of the borrower, whichever is higher. The additional provisioning may be reversed, among others, when (1) a resolution plan that involves restructuring or change in ownership outside the IBC is implemented; and (2) when the resolution is pursued under the IBC, half may be reversed on filing of the application and the rest upon admission of the borrower into the CIRP.

Creation and enforcement of security is governed by various pieces of legislation depending on the nature of the security, secured asset and the borrower and lender, including the Companies Act 2013, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (the SARFAESI Act), the Recovery of Debts due to Banks and Financial Institutions Act 1993 (the DRT Act) and the Transfer of Property Act 1882. Security by any company will require filing of prescribed forms with the Registrar of Companies (RoC) and in case of a mortgage of immovable property, registration with the sub-registrar of assurances of the jurisdiction where the property is located. Banks and financial institutions are also required to register certain securities with Central Registry of Securitisation Asset Reconstruction and Security Interest of India.

III  RECENT LEGAL DEVELOPMENTS

Some of the key amendments to the IBC include (1) deemed approval of shareholders for implementation of actions under a resolution plan (explanation to Section 30); (2) introduction of provisions relating to ineligibility of certain persons from participating in the CIRP or liquidation of a corporate debtor (Sections 29A and 35(1)(f)); (3) inclusion of home-buyers in real estate projects as financial creditors (Section 21 read with the definition of ‘financial creditor’); (4) reduction in various voting thresholds of COC (Sections 28, 30 etc.); (5) permitting withdrawal of an application to initiate an insolvency process (Section 12A); and (6) clarification of the scope of a moratorium (Section 14). However, not all issues can be addressed through legislation and some necessarily end up in courts and are settled through case law.

The insolvency process in India has seen a significant challenge in terms of litigation. The constitutionality of various provisions of the IBC has been challenged. There has also

\textsuperscript{11} Estimated realisable value of the assets of the borrower if the borrower was to be liquidated on the date of commencement of the review period.
been litigation in respect of individual cases on various grounds and issues such as reference to IBC (Visa Steel and Jaiprakash Associates Limited), the scope of the moratorium, value maximisation and process (in the case of Binani Cement), ineligibility of resolution applicants (in the case of Essar Steel), treatment of operational and other creditors (in the cases of Essar Steel, Jyoti Structures and Maharashtra Seamless) and withdrawal (in the case of Brilliant Alloys and Sterling Biotech).

The first key issue arose in the context of balance between value maximisation and sanctity of the process. In certain cases (such as Bhushan Power and Steel) the resolution plans were submitted after the date set out for submission of the resolution in the request for resolution plan document (RFRP). In the case of Binani it was upheld that value maximisation is a stated objective of the IBC. Subject to certain exceptions, the COC is bound to consider the plan which offers a higher value even if it is submitted after the date set out in the RFRP.

In Swiss Ribbons Private Limited & Anr. v. Union of India, the constitutional validity of various provisions of IBC was upheld by the Supreme Court. It was noted that Section 29A is not restricted to people who are malfeasant (such as undischarged insolvent) and the Supreme Court read down the wide definition of ‘relative’ and ‘related party’ to persons having a business connection with the resolution applicant. IBC is a beneficial legislation with primary focus on revival and continuation of the corporate debtor rather than a recovery mechanism for the creditors. The Supreme Court upheld the differential treatment of operational and financial creditors under the IBC and noted that there are inherent differences between operational and financial creditors and their contractual arrangements with the corporate debtor. The latter often engage in restructuring and are better placed to assess the viability of the corporate debtor; therefore, there is no constitutional infirmity in only financial creditors being part of COC.

It has been held that liquidation waterfall set out in Section 53 of the IBC does not apply in the context of a resolution plan under the CIRP process. Further, it has also been held that the allocation of amounts among the creditors cannot be discriminatory and some recent judgments have refused to take into account the security structure prior to insolvency. In the matter of Padmanabhan Venkatesh v. Shri V. Venkatachalam & Ors the NCLAT on 8 April 2019 rejected an approved plan of the committee of creditors proposed by Maharashtra Seamless Limited as it was below the liquidation value and was therefore discriminatory to the operational creditors. Further, in Essar Steel, NCLAT has queried the distribution of monies under the resolution plan approved by the COC and has asked the COC to reconsider allocating a higher amount to operational creditors. The allocation has also been challenged by Standard Chartered Bank, a secured financial creditor, as discriminatory. The final order in the matter is awaited.

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15 WP (Civil) No. 99/2018.
16 Binani, above note 8.
In the case of Dharani Sugar Mills, the Supreme Court set aside the RBI circular dated 28 February 2018 including any references to IBC under Section 7 solely on account of the circular. It observed that the RBI can direct banks to refer cases to the IBC only in respect of specific defaults and a direction for reference in respect of a class of debtors is not permitted under Section 35AA of the Banking Regulation Act 1949. This has provided significant relief to certain sectors such as power and textiles.

Originally under the IBC, once an application filed under the IBC was admitted, it could either lead to a successful resolution or liquidation but a withdrawal was not permitted except pursuant to exercise of inherent powers by the courts. Pursuant to an amendment, Section 12A was introduced in the IBC that allows for the withdrawal of a CIRP if 90 per cent of the COC approves such an application for withdrawal. Though the CIRP Regulations provide a time limit (prior to invitation for expression of interest); however, courts have held the time limit to be directory in nature. However, the withdrawal is not automatic and courts may examine the merits of withdrawal.

As observed above, the primary purpose of the IBC has been held to be revival, hence courts have in certain cases asked the COC to reconsider the resolution plans even if they have been rejected and the company should have been liquidated under the IBC. Courts have sought to revive the corporate debtor by directing its ‘liquidation as a going concern’. The IBBI has also introduced corresponding changes in the IBBI (Liquidation Process) Regulations 2016.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

The government had amended the Banking Regulation Act 1949 in 2017 through the Banking Regulation (Amendment) Ordinance 2017 (now Amendment Act), which introduced Sections 35AA and 35AB. The government of India issued a notification on 5 May 2017 to empower the RBI to issue directions to banks to initiate corporate insolvency resolution process in respect of a default, under the IBC.

In the first list issued by the RBI on 15 June 2017, 12 large defaulters constituting approximately 25 per cent of the total non-performing loans in India (the cumulative outstanding financial debt amounted to 1,977.69 billion rupees) were referred for insolvency resolution under the IBC. Thereafter, a second set of 29 accounts with total outstanding debt...
financial debt of 1,358.46 billion rupees were referred for insolvency resolution under the IBC in 2018. There have been litigations in relation to the accounts referred pursuant to the above lists. However, a majority of them are now admitted into the IBC and in some cases the insolvency resolution process has been completed (such as Bhushan Steel) or is near completion (such as Essar Steel, Monnet Ispat and Power, Bhushan Power and Steel, Uttam Value). In certain cases, the company has been referred to liquidation (such as ABG Shipyard).

In addition to the above, the RBI had also issued a circular for reference of large accounts aggregating more than 20 billion rupees to the IBC within a prescribed time frame, which was recently set aside by the Supreme Court.28

The RBI has now issued the RBI Circular (see Section I). The stressed assets in the power and steel sector have attracted significant interest. Other sectors such as telecoms, fertilizer, shipyards and infrastructure are also under stress. There were about 34 stressed power assets aggregating 40,130MW with a debt exposure of over 1744.68 billion rupees. Studies and committee reports29 have attributed the stress in the power sector to various factors including policy changes, non-payment of dues by offtakers, cancellation of coal block licences, fuel linkage issues and delay in the execution of long-term power purchase agreements.

Among recent informal work-outs of large accounts outside of the IBC, Prayagaraj Thermal Power and SKS Power are notable.

A sector-specific breakdown of insolvency cases as in March 2019 is set out below.

<table>
<thead>
<tr>
<th>Sector</th>
<th>No. of CIRPs</th>
<th>Closed</th>
<th>Ongoing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>324</td>
<td>448</td>
<td>772</td>
<td></td>
</tr>
<tr>
<td>Food, beverages and tobacco products</td>
<td>30</td>
<td>63</td>
<td>92</td>
<td></td>
</tr>
<tr>
<td>Chemicals and chemical products</td>
<td>30</td>
<td>45</td>
<td>75</td>
<td></td>
</tr>
<tr>
<td>Electrical machinery and apparatus</td>
<td>27</td>
<td>43</td>
<td>70</td>
<td></td>
</tr>
<tr>
<td>Fabricated metal product</td>
<td>23</td>
<td>27</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Machinery and equipment</td>
<td>38</td>
<td>45</td>
<td>83</td>
<td></td>
</tr>
<tr>
<td>Textile, leather and apparel products</td>
<td>52</td>
<td>75</td>
<td>127</td>
<td></td>
</tr>
<tr>
<td>Wood, rubber, plastics and paper products</td>
<td>33</td>
<td>47</td>
<td>80</td>
<td></td>
</tr>
<tr>
<td>Basic metals</td>
<td>67</td>
<td>73</td>
<td>140</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>24</td>
<td>30</td>
<td>54</td>
<td></td>
</tr>
<tr>
<td>Real estate, renting and business activities</td>
<td>128</td>
<td>231</td>
<td>359</td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td>59</td>
<td>143</td>
<td>202</td>
<td></td>
</tr>
<tr>
<td>Wholesale and retail trade</td>
<td>81</td>
<td>99</td>
<td>180</td>
<td></td>
</tr>
<tr>
<td>Hotels and restaurant</td>
<td>19</td>
<td>33</td>
<td>52</td>
<td></td>
</tr>
<tr>
<td>Electricity and others</td>
<td>12</td>
<td>35</td>
<td>47</td>
<td></td>
</tr>
<tr>
<td>Transport, storage and communications</td>
<td>20</td>
<td>30</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>72</td>
<td>124</td>
<td>196</td>
<td></td>
</tr>
</tbody>
</table>

28 Dharani Sugars, above note 1.
V INTERNATIONAL

The report of the Banking Law Reforms Committee formed the basis for the IBC. It was of the view that cross-border insolvency should be deliberated upon later once the domestic legislation is in place, though it recommended inclusion of a reciprocity provision in the IBC. Sections 234 and 235 of the IBC deal with cross-border insolvency. They envisage bilateral reciprocal arrangements with other countries to enforce the provisions of the IBC.

The Insolvency Law Committee, which has been reconstituted as a standing committee to examine the implementation of the IBC, has examined the issues relating to cross-border insolvency. It observed that there was a need to reassess the cross-border insolvency since the current framework is fragmented and not aligned with global practices. Its report on cross-border insolvency was issued on 16 October 2019. It includes a draft chapter on cross-border insolvency (part Z) which is largely modelled on the UNCITRAL Model Law with necessary tweaks to align it with the IBC. It is expected that the enabling legislative framework for cross-border insolvency will be enacted soon.

VI FUTURE DEVELOPMENTS

Some of the key changes on the anvil are noted below.

A draft chapter relating to cross-border insolvency has been proposed by the Insolvency Law Committee.

The Ministry of Corporate Affairs in the government of India had invited public comments on 16 April 2019 on proposed changes to the IBC for the consideration of the Insolvency Law Committee. The last date for submission of comments was 7 May 2019 and the comments will be examined by the Insolvency Law Committee, which will then propose suitable changes to the IBC. Among the comments sought, prepacks and group insolvency were specifically identified as areas of interest.

The government is also debating whether the provisions of the IBC relating to personal bankruptcy (for individuals and partnerships) should be notified. It is likely that the provisions may be notified in stages.

A working group under the chairmanship of Mr UK Sinha has also been constituted to consider group insolvency framework. The NCLT had admitted the insolvency plea against Videocon (the parent company) in June 2018. Thereafter the lenders had moved separate insolvency petitions against various subsidiaries of the parent group. To ensure a uniformity of process in respect of the insolvency of the group, NCLT in exercise of its inherent powers has directed the transfer of all insolvency petitions related to Videocon group to a single bench.

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31 Report of Insolvency Law Committee on Cross-border Insolvency, 16 October 2018.
VII CONCLUSION

The data available so far shows unambiguously that the implementation of the IBC has been a success story. Both lenders and operational creditors have benefitted immensely from the resolutions, far in excess of our experience with any restructuring, enforcement or liquidation. The government and the regulators have been very actively involved in rectifying and strengthening the insolvency framework in light of issues faced during the implementation of the IBC. The judiciary has also played a very supportive role. As very aptly observed by Justice Nariman – ‘The defaulter’s paradise is lost. In its place, the economy’s rightful position has been regained.’
Ireland

Barry Cahir

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

Positive market conditions and improved sentiment towards Ireland have given rise to a strong recovery for the Irish economy.

One of the key indicators of the continued renaissance in the Irish economy has been the performance of the domestic banking sector. While domestic institutions, the Exchequer and indeed debtors still suffer the overhang of overtrading, in aggregate the banking sector returned to profitability in 2014 for the first time since 2008 and continues to thrive. This has led to a rise in lending, further supporting the economic recovery.

Ireland continued to experience strong growth in 2019. Gross domestic product (GDP) grew by 6.7 per cent in 2018 compared with 2017. The Spring 2019 European Economic Forecast estimates that Ireland will experience a 3.8 per cent growth in 2019. Underlying economic activity is expected to remain robust, driven by investment in construction and positive labour market developments. The government deficit is projected to turn into a surplus, but risks to the fiscal outlook remain due to the uncertainty from external factors such as Brexit, as well possible changes in internal taxation and trade.²

The impact of Brexit on the Irish economy remains uncertain. The Central Bank of Ireland’s 2018 Q2 quarterly review notes the main issue facing the Irish economy is Brexit and, in particular, the possibility of a disorderly Brexit.

Moody’s, the credit rating firm, raised its outlook for Irish banks to ‘positive’ in 2018 as the quality of loans improves with a growing economy. The ratings agency expects that the impact of Brexit on the Irish market is likely to be ‘contained’.³

There were 767 corporate insolvencies recorded in 2018, a drop of 107 (12 per cent) from the previous year, and below the peak of 2012 when a total of 1,684 insolvencies were recorded.⁴ The breakdown of these insolvencies remains relatively unchanged, with creditors’ voluntary liquidations accounting for 70 per cent of the total number (539), receiverships comprising 28 per cent, court-ordered liquidations 8 per cent and examinerships only 3 per cent. This trend is likely to continue during 2019.

¹ Barry Cahir is a partner at Beauchamps. The author wishes to thank Denise O’Shaughnessy.
The level of examinerships continues to remain notably low. While legislative changes in 2014 were promoted on the basis of reducing costs, the substantive requirements for entering examinership were not simplified. Therefore, accessing the process is still challenging for smaller companies.

The impact and remit of the Insolvency Service of Ireland (ISI) has continued to grow since its establishment in 2013. The ISI is an independent statutory body established to restore insolvent persons to solvency. In Q4 2018 the ISI received 753 new applications. The number of debtors securing personal insolvency arrangements continues to grow steadily and has increased by 41 per cent compared to Q4 2017.5

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

Corporate restructuring and insolvency processes in Ireland are governed by a blend of statute, law and common law, the most important statute being the Companies Act 2014 (the Companies Act).

Ireland has two forms of schemes of arrangement under the Companies Act, the examinership scheme and the Companies Act scheme.

i The examinership scheme

Examinership legislation was enacted in 1990 and is modelled in large part on US Chapter 11 proceedings. As such, it provides companies (large or small) that are temporarily unable to pay debts as they fall due the opportunity to explore options to ensure their survival.

On filing a court petition, the company is protected from its creditors by an automatic moratorium for a period of up to 100 days.

An independent officer called the examiner is appointed and charged with examining the state of the company’s affairs with a view to compiling a restructuring plan for the company’s future viability (the examinership scheme).

The court may appoint an examiner to a related company if it would ‘facilitate the survival of the company, or of the related company, or both’.6 There are a number of provisos around this section but the definition of ‘related company’ is extensive.

There is a heavy focus on saving jobs and the court requires an independent expert’s report to the effect that there is a reasonable prospect of survival of the company (or a part of the company) as a going concern.

The directors of the company will generally remain in control of and responsible for the day-to-day running of the business.

An examinership scheme is often achieved through new investment in the company, a write down of debt, forced surrender or termination of property leases and or reformulated debt repayments. There are very few, if any, restrictions on the nature of the proposals that the examiner may formulate to achieve this.

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6 Section 517(2) Companies Act 2014.
Many well-known retailers\(^7\) have used examinership to disclaim or repudiate onerous leases. The residual lease obligations can then be crammed down as part of the examinership scheme. Landlords facing disclaimer or repudiation may negotiate reduced lease obligations or dispute the terms on offer.

Once the examiner has formulated a scheme, the creditors are invited to consider it. Creditors with similar economic and legal interests will be classed together for these meetings. Voting to accept the scheme is by majority in number representing a majority in value of the claims represented at each class meeting. This is a significantly lower threshold than is required for comparable schemes in other jurisdictions.

It is a statutory requirement that at least one class of impaired creditors has accepted the scheme proposals before the court can confirm it. The court will also consider whether the scheme proposals are fair and equitable to the creditors. Once approved by the court the scheme will take effect.

The examinership scheme is enforceable throughout the EU by virtue of being scheduled in the European Insolvency Regulation (EIR)\(^8\) and EIR Recast.\(^9\)

*Eircom Limited*\(^10\) is a good example of the effective use of examinership in a cross-border restructuring of large financial obligations. The Eircom group of companies owed €4.08 billion to financial creditors. Of that amount, €2.659 billion was fully secured first lien debt. The second lien debt amounted to €350 million. It was also secured but subordinated to the first lien debt. A further €350 million was owed to holders of floating rate notes (FRNs) secured on shares in ERC Ireland Holdings Limited. A further €699 million was owed to holders of payment in kind notes. In addition, there were significant trade and other debts.

Due to pre-filing negotiations, the examinership scheme writing €1.4 billion off the total debt was confirmed by the court within 54 days of the filing. It is reported\(^11\) that the senior lenders took a 15 per cent write down on their debt, the second tier received 10 per cent of the value of their debt and the last two layers were crammed down entirely. The senior lenders became the new owners of the business. There was no objection to the scheme.

### ii The Companies Act Scheme

The Companies Act Scheme has been reasonably well used, although more often of late for corporate reorganisations, mergers and de-mergers than for insolvent restructurings.

The essential features of the Companies Act Scheme may be summarised as follows:

- **a** a compromise or arrangement is proposed between a company and its creditors or any class of them;
- **b** directors may convene meetings of creditors without court order;
- **c** the court may order a moratorium for such period as it sees fit;
- **d** creditor approval requires a majority in number representing three-quarters in value (of each class); and
- **e** court sanction hearing at which process and form, and a ‘fair and equitable’ or ‘reasonable man’ test is applied.

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\(^7\) Examples include Bestseller Retail Ireland Limited (Vero Moda, Jack and Jones), Debenhams & B&Q.


\(^11\) *Financial Times*, 11 June 2012.
In the Matter of Colonia Re Insurance (Ireland) Limited\textsuperscript{12} Mr Justice Kelly approved a Companies Act scheme to shorten the time frame involved in quantifying and paying insurance run-off liabilities. The court cited with approval Mr Justice Neuberger in Re Osiris Insurance Limited\textsuperscript{13}, Buckley on the Companies Acts\textsuperscript{14} and Lord Justice Lindley in Re English, Scottish and Australian Chartered Bank.\textsuperscript{15}

In the Matter of Depfa Bank Pte,\textsuperscript{16} Mr Justice Kelly approved a Companies Act scheme whereby Hypo Real Estate Holdings AG acquired all of the issued share capital in Depfa Bank PLC for a consideration paid partly in cash and partly in shares in Hypo Real Estate Holdings AG.

In a recent judgment, the Irish High Court sanctioned a Companies Act Scheme that aimed to restructure a company’s reinsurance obligations and its outstanding indebtedness to enable the residual value in the company to be distributed to the scheme noteholders despite a US creditor’s objection.\textsuperscript{17}

The company, Ballantyne Re PLC is an Irish registered PLC formed as a special purpose vehicle for the purpose of entering into a reinsurance agreement and (the company). The company applied to the High Court of Ireland to sanction a proposed scheme of arrangement between it and its creditors (the scheme). The sole objecting creditor, ESM Fund I LP, (ESM) a limited partnership formed in the United States opposed the company’s application. ESM contended the scheme was deficient in terms of the information it provided and the impression it created. It further claimed that the Irish court had no jurisdiction to sanction a scheme that provides for third-party releases and that its sanctioning would frustrate existing litigation that ESM had initiated in the United States.

The parties accepted that a special majority of creditors voted in favour of the scheme as required by the Act and that adequate notice of the passing of the resolutions in favour of the scheme was established.\textsuperscript{18} The High Court endorsed Re Osiris Insurance Limited (cited above) and ultimately held that the scheme was reasonable, fair and equitable to all creditors viewed from the perspective of an honest, intelligent and experienced person of business who is familiar with the scheme.

The Irish Court had jurisdiction as the company is registered in Ireland, its directors are Irish and all board meeting were held in Ireland.

In terms of EU recognition and enforceability of the Companies Act scheme, the court relied on evidence of compliance with European law requirements, an opinion from German lawyers and consent from the EU Commission.

\textbf{iii Receivership}

Receivership is, in essence, the enforcement of security by the lender on default of loan or security covenants by the borrower. The most common form of receivership is an appointment by the holder of security created by a mortgage, charge or debenture.

\begin{itemize}
  \item \textsuperscript{12} [2005] IEHC 115.
  \item \textsuperscript{13} [1999] 1 B.C.L. 182.
  \item \textsuperscript{14} Buckley on the Companies Acts (1981 edition) 473-474.
  \item \textsuperscript{15} [1893] 3 Ch. 385 at page 409.
  \item \textsuperscript{16} [2007] IEHC 463.
  \item \textsuperscript{17} Re Ballantyne RE Plc & the Companies Act 2014 [2019] IEHC 407.
  \item \textsuperscript{18} Section 432(2)(a) of the Companies Act outlines the special majority requirements. Notification requirements are stipulated in Section 253(2)(b) of the Companies Act.
\end{itemize}
While the remedy of appointing a receiver is not truly a collective insolvency procedure, being a procedure of enforcement of rights under a charge, it is a procedure that may be used in many cases to achieve a sale on a going concern basis of a company’s entire assets and undertaking.

Unlike other processes, however, the appointment of a receiver does not, of itself, affect the legal status of the company. Rather, the appointment of the receiver affects the status of the charged assets.

Most debentures contain specified fixed charges and a floating charge on all the assets and undertakings of the borrower company. Debentures typically provide for enforcement in the event of default by the appointment of a receiver with full power to take possession of and manage all of the secured assets and the power of sale of the assets. The powers and duties of a receiver are governed by the terms of the debenture itself and are supplemented by Part 8 of the Companies Act, which includes the following powers:

- to enter into possession and take control of the property of the company;
- to lease, let, hire, grant options over or dispose of such property;
- to carry on the business of the company; and
- to execute documents, bring proceedings and use the seal of the company (a new power) to engage or discharge employees, and to appoint professionals and agents.

The Companies Act does not attempt to delimit the duties of receivers but does codify in Section 439 the obligation, in selling property of the company, to exercise all reasonable care to obtain the best price reasonably obtainable for the property as at the time of sale.

**Liquidation**

Liquidation is the ultimate collective insolvency procedure, being a winding up of a company leading to its dissolution. A liquidator assumes full power and authority over the company, realises the assets and applies the proceeds in accordance with the rules set down by the Companies Acts, the Rules of the Superior Courts and a substantial body of case law.

There are two means by which an insolvent company may be wound up or liquidated: creditors’ voluntary liquidation or compulsory liquidation.

**Creditors’ voluntary liquidation**

The vast majority of liquidations are creditors’ voluntary liquidations. These are commenced by ordinary resolution of the shareholders, prompted by a recommendation from the board of directors of a company to the effect that, by reason of its liabilities, the company should cease trading.

A meeting of all creditors of the company is convened on at least 10 days written notice. If creditors representing a majority in value of those attending and voting at the meeting resolve to appoint a different person as liquidator to the person nominated by the shareholders, then the person so approved by the creditors shall be the liquidator.

Generally speaking, on the appointment of a liquidator the powers of the directors will cease and the liquidator effectively displaces the directors.

**Functions of liquidator**

The principle function of the liquidator is to realise all of the assets of the company and then distribute the proceeds of the sale of the assets broadly in accordance with the following priorities:
Ireland

The discharge of the costs, fees and expenses of the winding up;

b payment to secured and preferential creditors;

c payment to unsecured creditors; and

d payment of a distribution to members if there is a surplus available after (a), (b) and (c) above.

The liquidator conducts the liquidation independently of all parties and reports on the conduct of the liquidation to meetings of the members and creditors.

Compulsory liquidation

Compulsory liquidations are commenced on the basis of the jurisdiction of the High Court to order the winding up of a company and appoint a liquidator.

The process commences with a petition to court. The parties who may petition the court for an order for the appointment of a liquidator include creditors, members or the company itself.

Section 569 of the Companies Act 2014 provides for a number of circumstances in which the court may order a winding up, including where the company is unable to pay its debts as they fall due.

Provisional liquidator

After a petition to have a company wound up is presented, and before making the order for the winding up of a company, the court may order the appointment of a provisional liquidator under Section 573 of the Companies Act. The primary purpose of the appointment of a provisional liquidator is the preservation of assets pending the winding-up order based on a concern or requirement that the value, assets and business of the company are immediately preserved in the interest of creditors.

The provisional liquidator will represent all of the creditors of the company and must act in all of their interests. The compelling grounds to appoint a provisional liquidator must be clearly set out by the petitioner in the grounding affidavit to the winding-up petition.

The powers of a provisional liquidator are limited but can be expanded by the court. For example, a provisional liquidator’s power to carry on the business of the company will generally only be to do so insofar as is necessary to facilitate a beneficial winding up of the company.

Directors’ duties and responsibilities where a company is in financial difficulties

If a company becomes unable to pay its debts as they fall due, or if there is a prospect (whether based on the cash-flow test or the balance sheet test) that creditors will not be paid in full the duties owed to the shareholders become secondary to an overriding duty to act in the best interests of the creditors, including contingent or prospective creditors.

Failure by the directors to act in the best interests of creditors at such a point may result in personal liability for all or some of the debts of the company.

In cases where a company is unable to pay its debts as they fall due (i.e., it fails the cash-flow test) it is difficult to justify continued trading unless the directors believe on reasonable grounds that the company can survive and that all debts will be paid.

The critical point is that the duty to act in good faith and to exercise the utmost care, skill and diligence, is a duty that in those circumstances is owed to the creditors.
Potential sanctions
The Companies Act sets out the sanctions of restriction and disqualification of directors and the circumstances in which a court may impose personal liability on directors of a company.

Restriction
In every insolvent liquidation, the liquidator must bring an application for a restriction order before the High Court unless the liquidator is relieved from doing so by the Office of the Director of Corporate Enforcement (ODCE).19

This obligation applies to every person who has been a director in the 12 months prior to the commencement of the winding up (including shadow directors).

The ODCE makes its decision based on a comprehensive report of the liquidator that must be made within six months of his or her appointment.

The burden is on the directors to prove that they have acted honestly and responsibly in relation to the affairs of the company and that they have cooperated with the liquidator.

The effect of a restriction order is that such a person may not act as a director or be concerned in any way in the management of another company for a period of up to five years unless that new company meets defined capital requirements.

Disqualification
Section 842 of the Companies Act provides for the disqualification of persons from acting as directors, officers or otherwise being concerned in the management of the company for a period of five years, or for such periods as the court may order.

A disqualification order is more absolute than a restriction order, but such an order will only be made where culpable wrongdoing on the part of the director has been established.

The grounds for making a disqualification order include where the person has been guilty of any fraud in relation to a company or guilty of conduct rendering such a person unfit to be concerned in the management of a company.

Restriction and disqualification undertakings
Where the ODCE believes that a person may properly be subject to a restriction or disqualification application they will be invited to elect to give an undertaking to be subject to a restriction declaration or a disqualification order for the purposes of the legislation.

Requests for undertakings can only be given by the ODCE, and not by the appointed liquidator or receiver.

Reckless trading
Section 610 of the 2014 Act imposes personal liability for all the debts of a company on any person who, while an officer of the company, has been knowingly party to the conduct of any business of the company in a reckless manner.

There are a number of instances of conduct that are deemed to constitute reckless trading, including where the director in question ought to have known that his or her actions or those of the company would cause loss to the creditors of the company or to any of them.

19 Section 819 of the Companies Act.
Fraudulent trading
Section 722 of the Companies Act imposes criminal and civil liability on a person who is knowingly party to the carrying on of the business of the company with intent to defraud creditors of the company.

Floating charges
A floating charge created within 12 months before the commencement of the winding up is invalid unless it is proven that the company was solvent immediately after the creation of the charge. This provision in Section 577 of the Companies Act does not apply in respect of money actually advanced or paid, or the actual price or value of goods or services sold or supplied to the company at the time of, or subsequent to the creation of the floating charge, and is consideration for the charge.

Where the chargee is a party connected to the company, the period of 12 months for testing the floating charge is extended to two years.

Contribution by a related company
The High Court may order a related company to contribute to the whole or part of the debts of a company being wound up if satisfied in accordance with Section 599 of the Companies Act that such an order is just and equitable.

In making such an order, the court must have regard to (1) the extent to which the related company took part in the management of the company being wound up; (2) the conduct of the related company towards the creditors of the company being wound up; and (3) the effects that such an order would be likely to have on the creditors of the related company.

Pooling assets of related companies and effective consolidation orders
The grounds for a pooling order under Section 600 of the Companies Act are based on (1) the extent of involvement by one company in the management of the other (2) the conduct of each company towards the creditor of the others (3) the extent to which the circumstances giving rise to the winding up of the companies are attributable to the conduct of each other and (4) the extent to which the businesses of the companies have been intermingled.

Where a court makes a pooling order, it must respect the rights of secured creditors (both fixed and floating charge holders) in each company separately. Otherwise, the claims of unsecured creditors rank equally in the consolidated entity.

Unfair preference
Any disposal or other action by an insolvent company in favour of a creditor made with a view to giving that creditor a preference over other creditors is invalid as an unfair preference. Section 604 of the Companies Act, applies if a winding up commences within a period of six months from the date of the disposal or other action in favour of a creditor. Where the transaction is in favour of a party connected to the company, the six-month scrutiny period is extended to two years and there is a statutory presumption of intent to prefer.
**Assets improperly transferred (Section 608)**

A court may, under Section 608 of the Companies Act, order restitution against a disponee where the effect of a disposal of the property of a company is to perpetrate a fraud on the company, its creditors or members. The test is whether the transaction has the effect of depriving the company or its creditors of assets that would otherwise have been available to it.

### III RECENT LEGAL DEVELOPMENTS

#### i Personal Insolvency Amendment Act 2015 (the 2015 Act)

The 2015 Act amended the Personal Insolvency Act 2012 and enabled the Court to confirm a personal insolvency arrangement (PIA) that had been rejected by majority vote of the secured lender.

The Act provides that a personal insolvency arrangement could be used to write down secured debt up to €3 million. A debtor is eligible for a PIA if he or she fulfilled certain criteria and had aggregate secured debts of up to €3 million. The limit of €3 million may be waived where all creditors agree.

PIAs in Q1 2019 increased by 16 per cent in comparison with Q1 2018 and bankruptcy adjudications decreased in the same period by 31 per cent. There is a consistent trend of bankruptcies declining, wherein 526 were filed in 2016 and 397 were filed in 2018.

### IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

While the number of examinerships have been quite low, companies in the construction, energy and retail sector have been the most prominent candidates.

Sammon Contracting Ireland Limited, a leading Irish building contractor that employed 216 people was contracted to build a significant number of public and educational facilities by an entity that included Carillion, the UK contractor. However, Carillion were experiencing immense financial difficulties and had debts that exceeded £1.5 billion. Sammon was severely impacted by the collapse of Carillion and was pushed into examinership. The examinership was unsuccessful in that the examiner was unable to formulate an examinership scheme and the company went into liquidation.

Naval Energies, a French company and leader in the marine renewables energy sector ceased to support its investments in tidal turbines in 2018 with the result that its Irish subsidiary OpenHydro went into liquidation. The company founders and minority shareholders of OpenHydro lodged an examinership petition that was rejected by the High Court.

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22 *In the matter of Sammon Contracting Ireland Limited and in the matter of the Companies Act 2014 (2018/137 COS).*

Court as there was no chance of the company securing fresh investment and therefore it had no reasonable chance of survival. The liquidation application to wind up the company was made by Naval Energies which was the largest shareholder and creditor of OpenHydro.

Dennis Moriarty (The Kerries) Limited is a significant supplier of engineering and grounds work services to the wind farm sector. It successfully secured new investment and completed a restructuring through examinership despite the challenges its faced in the sector.

Retail featured prominently, including in the case of Bradleys Pharmacy Group, which was successfully restructured through Examinership with the saving of a significant number of jobs.

Well-known Irish optician chain MacNally Opticians is at the time of writing under the protection of the court in examinership.

V INTERNATIONAL

i EIR applies

Liquidations and examinership are enforceable throughout the European Union by virtue of being scheduled in the EIR and now in the EIR Recast.

Chapter 15 of the Companies Act contains specific provisions to facilitate the operation of the Insolvency Regulation in Ireland, including provisions governing the publication of the opening of insolvency proceedings, court confirmation of the appointment of a liquidator in a voluntary liquidation, and provision for the translation of claims of creditors into the Irish or English language, as required by the liquidator in individual cases.

ii EU ‘Second Chance’ Directive

As of 15 May 2019, the EU Directive on Preventive Restructuring Frameworks has been adopted. The Directive is based on and closely resembles examinership.

Ireland and all applicable EU Member States will now be required to transpose the Directive’s provisions into the legal system within two years.

The stated aim of the Directive is to provide increased access to preventive restructuring frameworks at an early stage for viable enterprises in financial difficulties.

iii UNCITRAL Model Law on Cross-Border Insolvency

The Company Law Review Group (CLRG) is a statutory body established to advise the Irish Minister for Enterprise, Trade and Employment (the Minister) on the reform and modernisation of Irish company law.

The CLRG recently published a detailed report recommending that the UNCITRAL Model Law on Cross-Border Insolvency be adopted.

28 (EU) 2017/1132.
29 http://www.clrg.org/Publications/.

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With an eye on supporting further foreign direct investment and on Brexit, the adoption of the Model Law in Ireland would provide greater certainty and predictability to companies to which the EU Regulation does not apply, and their creditors, as to how cross-border insolvencies are treated in Ireland.

VI FUTURE DEVELOPMENTS

The insolvency market continues to be dominated by the enforcement of security by alternative lenders who have acquired loan portfolios, predominantly from state-sponsored banks and ‘bad banks’.

While the range of lenders available to businesses has expanded, the ratio of non-performing loans on the books of domestic banks still make for a challenging environment. That is especially so for smaller businesses who cannot easily source borrowings for cash-flow purposes.

It was recently reported\(^\text{30}\) that the state’s chief economist, John McCarthy, has described the economy as ‘being on a knife edge, poised between “overheating” and a major Brexit-related downturn’.

In any event, recent improvements to company law generally coupled with recent and anticipated changes to insolvency law in particular should mean that businesses seeking timely advice will be well placed to restructure a business before it deteriorates to the point of no return.

IITALY

Tiziana Del Prete¹

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

i Liquidity and state of the financial markets

The trend in macroeconomic terms on the Italian market continues to be positive in 2019, although the growth of Italian productivity is lower compared to other European countries.

The very high public debt remains a heavy burden on the Italian economy and a major source of vulnerability, especially in the context of protracted weak growth.

The figures for 2018 relating to the public debt and presented in the Economic and Financial Document which contains the economic and financial policies decided by the Italian government on an annual basis, showed that public debt is equal to 130.8 per cent of GDP. In 2019, the debt-to-GDP ratio is expected to be 128 per cent, thus confirming the reversal trend of recent years.

Overall, companies’ financial positions have continued to strengthen gradually; bankruptcies have diminished by 7 per cent compared to the previous year.

In this context, the existence of huge numbers of non-performing loans still represent a serious concern for Italian financial markets. On this point, great attention should be paid to the innovations brought by Law Decree No. 18 of 14 February 2016, as subsequently amended, which introduced a public guarantee mechanism applicable to the securitisation procedure of non-performing loans, thus improving the economic value of doubtful loans and the stability of the financial system as a whole.

ii Market trends in restructuring procedures and techniques employed during this period

The latest figures related to insolvency and bankruptcy procedures have shown a steady improvement over the previous year.

Statistics from the archives of the CERVED Group SpA show that, in the fourth quarter of 2018, 3,029 companies applied for a bankruptcy procedure – a decrease of 7.9 per cent compared to the same period of the previous year.

Furthermore, the decline in non-bankruptcy proceedings continued at a steady pace: 379 procedures were opened in the fourth quarter of 2018, 20 per cent fewer than in the same period of the previous year. At the origin of this improvement, there is the sharp decrease in the filing of composition with creditors’ procedures (concordato preventivo): only 491 petitions were filed in the year 2018.

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On the other hand, statistics show that 451 compulsory liquidations and voluntary liquidations were opened in 2018: this is a pronounced decrease that brings the figure back to the levels of 2016.

This is, in summary, the picture emerging from the data relating to bankruptcy proceedings and voluntary liquidations opened in the fourth quarter of 2018.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

The main source of Italian insolvency law until August 2020 is the Royal Decree No. 267 of 16 March 1942 (the Insolvency Act), as amended and integrated from time to time by the Italian legislature. As will be discussed in Section VI, the Italian government, in application of the Law No. 155 of 19 October 2017, issued Legislative Decree No. 14 of 12 January 2019, containing the Code of the Business Crisis and Insolvency, substantially reforming the procedures used to manage business crises and insolvency. This reform will enter into force in August 2020 and the new rules will apply to proceedings that start after this date.

The Insolvency Act currently in force provides for several bankruptcy and restructuring proceedings that have been amended in the last years and some of which are described below.

i Legal procedures

Bankruptcy

The bankruptcy proceeding is the most invasive procedure for a debtor. The law specifically indicates which debtors are subject to the bankruptcy procedures (not all debtors can fall bankrupt). In general, the bankruptcy procedure applies to any company or individual entrepreneur whose main activity consists of the production or trade of goods and services. A debtor is declared insolvent when it is no longer able to regularly meet its payment obligations through ordinary means. The insolvency status is per se a situation that justifies a declaration of bankruptcy by the relevant court, even if the insolvency has not been caused by the debtor’s misconduct.

The procedure is started by an order of the court having jurisdiction over the debtor's principal place of business on the basis of a petition, which may be filed by the debtor itself (or the directors of the debtor company), a creditor, the public prosecutor, or the bankruptcy court ex officio.

The proceeding is carried out and supervised by a receiver (appointed by the court), a deputy judge and a creditors’ committee representing all the creditors.

Upon declaration of bankruptcy by the court, the debtor no longer has the legal right to manage its business and dispose of its assets. All legal individual actions taken by the creditors against the debtor and its assets are suspended.

The receiver is a public officer and is required to perform his or her duties in person. The receiver is paid through the debtor’s assets, and such remuneration ranks as senior over the creditors’ unsecured claims. The Insolvency Act imposes certain specific duties on the receiver: in particular, to manage the company’s assets and operate the business in the interest of the creditors. His or her main task is that of disposing of the company’s assets and distributing the relevant proceeds to the creditors, who will be reimbursed according to a distribution plan, which must respect the order of claim priorities established by the Italian Civil Code.
and by several provisions of the Insolvency Act, and be certified by the court. Priorities are normally granted to claims secured by pledges, mortgages or other liens voluntarily granted by, or imposed on, the debtor. Claims of Italian and foreign creditors rank equally.

Before the execution of the distribution plan, the receiver must submit a final report to the deputy judge with a full description of all the activities carried out in managing the debtor’s assets as well as in administering its business. Creditors may object to the final report. Once the motions have been decided, the deputy judge orders the implementation of the distribution plan. Creditors are always entitled to file oppositions against the distribution plan in order to obtain payment of any unrecovered portion of their claims and of interest thereon.

Bankruptcy proceedings may also end up with a settlement accepted by the creditors, as will be described below.

It is worth noting that significant changes to the bankruptcy proceedings have been introduced by Law No. 132/2015. In particular, it introduced the following provisions regarding the appointment and the revocation of the receiver, the liquidation phase and the maximum duration of the procedure:

a litigation procedures that are related to the bankruptcy proceedings are treated as a priority by courts;

b the receiver shall provide a liquidation plan within 60 days of the draft of the inventory and in any case no later than 180 days from the bankruptcy declaration. Law provides for the revocation of the receiver in case of non-fulfillment of these obligations;

c payment of liquidated assets prices can be made by instalments;

d the liquidation procedure can be completed notwithstanding pending litigation. Further incomes will be distributed according to the court resolution for the approval of the distribution plan; and

e the completion of the liquidation procedure shall occur within two years of the bankruptcy declaration. Time extensions can be granted in specific circumstances.

**Settlement of bankruptcy proceedings**

The Insolvency Act allows creditors and, under certain circumstances, the debtor to have recourse to a settlement procedure in bankruptcy. In particular, once the court has set out a timetable for the distribution of proceeds, a settlement proposal can be submitted by a creditor or the debtor, provided that the proposed settlement, in principle, guarantees a greater or faster recovery than the one envisaged under the bankruptcy distribution.

If the court decides that the settlement proposal is in the best interests of the creditors, the court orders to notify the proposal to all creditors for their approval. For the settlement to be effective, the proposal has to be accepted by the majority of creditors.

**Composition with creditors proceedings**

While the bankruptcy procedure is highly regulated and is under the full control of the court and the receiver, an higher level of autonomy is granted to the debtor in the context of the composition with creditors’ proceedings.

In general, a company applies for protection under a composition procedure when it is either insolvent (but believes it is in a position to be able to repay its creditors, at least partially) or is in financial crisis but not yet insolvent.

The court, once it has admitted the company to the procedure, appoints a commissioner who acts as a public observer.
During the procedure, the assets continue to be managed by the debtor, while the commissioner supervises the management of the company in the interest of the creditors.

The petition must be accompanied by a *concordato* plan, which shall include:

- an updated economic and financial statement of the company;
- an analysis of all the economic activities carried out by the company, including a list of all creditors and a description of the relevant credits and of any pre-emption rights;
- a list of all people having personal and property rights over the debtor’s assets; and
- an estimate of the value of the debtor’s assets and particular categories of creditors.

The *concordato* plan must indicate how and to which percentage the creditors will be repaid (see the limitations indicated in (b) above) and must be accompanied by a report, drafted by an independent third-party expert, certifying the correctness of the company’s data and the feasibility of the plan. The commissioner, inter alia, expresses his or her opinion on the feasibility of the *concordato* plan.

As a general rule, the *concordato* plan must be approved by the majority of the unsecured creditors while secured creditors do not vote to the extent that the plan envisages the repayment of their credits in full.

The procedure is regulated by the court, which plays a key role in terms of supervision and implementation. Although an intensive debate exists regarding the admissible level of court intervention, much depends on the approach of the territorial court where the procedure is started. Another significant characteristic of the composition procedure is that, once approved with the prescribed majorities, the *concordato* plan is binding on all creditors (even those dissenting).

The debtor may anticipate the effects of a *concordato* procedure by submitting a petition for composition with creditors without a *concordato* plan, and postponing the filing of the plan and of all the other documents required by law at a later stage (the pre-*concordato* request). The pre-*concordato* request must be filed together with the three latest approved balance sheets of the debtor and a detailed list of all its creditors. The condition for the admittance is that a petition for *concordato* was not unsuccessfully filed by the debtor in the previous two years.

Following the filing of a pre-*concordato* request, the court, subject to its positive evaluation of the same, admits the debtor to the pre-*concordato* phase, granting a term between 60 and 120 days (which can be extended for no more than 60 additional days) for filing the *concordato* plan and all other related documents. The pre-*concordato* proceeding is intended to allow the debtor to seek immediate protection against enforcement or interim actions brought by individual creditors. During the pre-*concordato* phase, however, all activities exceeding the ordinary course of business must be authorised by the court. The court often sets thresholds of value above which such authorisation is required.

During the pre-*concordato* phase, the debtor must provide certain periodical information (mainly financial) to the court, and the court may appoint a judicial officer to monitor the company’s activities in the interest of all creditors.

Distressed companies often pose a risk for their partners and counterparties; in fact, in the event that the company is declared bankrupt, any payments made by the debtor up to one year prior to the commencement of the bankruptcy proceedings are at risk of being clawed back or revoked (see Section II.iii). This can often result in further deterioration of the business of the company, thus worsening its crisis. To avoid this, as well as to create incentives for the debtor’s business partners to continue dealings with the debtor and facilitate access to credit during the crisis, the law provides, among other things, the following:
from the day on which the request is filed with the Register of Companies (i.e., one day after it is submitted to the court), the debtor may be authorised to engage in specific transactions in the ordinary and extraordinary course of business. All credits resulting from authorised transactions (including unsecured ones) are granted priority status (even over secured pre-petition claims, with certain exceptions);

payments made by the debtor in connection with authorised transactions are not subject to claw back action in case of subsequent bankruptcy of the debtor; and

similarly to ‘first-day orders’ set forth by the US Bankruptcy Code, the court may allow the debtor to pay pre-petition claims of critical vendors and suppliers.

Along the same lines, the debtor is allowed to terminate unprofitable or excessively burdensome unperformed contracts with the prior authorisation of the court. This is aimed at preserving the goodwill of the debtor and increasing the chances of its recovery.

Certain ground-breaking changes have been made to this procedure. In particular:

creditors representing at least 10 per cent of the total debt are entitled to file a competing proposal for a concordato preventivo plan, which shall then be evaluated by the creditors alongside the one filed by the debtor. This right is not granted if the concordato plan filed by the debtor provides that at least 40 per cent of unsecured creditors are repaid (30 per cent if the plan provides for business continuity);

a concordato plan that does not provide for business continuity but aims at the liquidation of the debtor’s assets for the benefit of the creditors shall provide that at least 20 per cent of the unsecured creditors are repaid;

the court shall start a compulsory tender for the research of the best offer in the event the concordato plan provides for the transfer of the company, of a going concern or of key assets. Offers will be compared on an economic basis. The court is required to set the criteria for the tender, to be determined on a time-to-time basis depending on the specifics of the case; and

a debtor who has already filed a petition for the admission to a creditor composition procedure or an application for the approval of a debt restructuring agreement can obtain new financing or continue to use existing receivables credit lines on an urgent basis provided that:

- the new financing is required for urgent operational needs;
- the debtor is unable to obtain the financing in a different way;
- the debtor indicates the envisaged use of the financing; and
- not granting the financing would result in the disruption of the business continuity.

**Debt-restructuring agreements**

Debt-restructuring agreements, regulated by Article 182 bis of the Insolvency Act, are private agreements whereby the debtor and creditors representing at least 60 per cent of the total credits reach an agreement on the restructuring and repayment of the debtor’s debts. Restructuring agreements need to be validated by a third-party independent expert as to their feasibility and are subject to confirmation by the competent court.

Dissenting creditors, however, are not bound by the restructuring agreement and their credits need to be repaid in full within 120 days from the date when the court approves the restructuring agreement or, if longer, from the date when the relevant debts become due.

Certain similarities exist in the restructuring agreements, as well as in the concordato procedure:
debtor may submit an application to the court to obtain new debtor-in-possession (DIP) financing from banks or other sources of credit, and to pay creditors that are crucial to ensuring the continuity of the business. Such financing will rank as a senior priority, which is an incentive for lenders to provide financing to a distressed company; transactions carried out by the debtor pursuant to a restructuring agreement are not subject to claw-back action in the event of subsequent bankruptcy of the debtor; and the provisions of law imposing the reintegration of corporate capital in the event of losses are not applicable. This is designed to give a distressed company a breathing spell to prepare a restructuring plan without the pressure of complying with corporate capital requirements and injecting new equity when the survival of the company is still in doubt.

Furthermore, Article 182 septies of the Insolvency Act provides that, in the event the majority of the total debt is due to credit and financial institutions, a restructuring agreement entered into by the debtor and creditors holding at least 75 per cent of credits falling into such category is automatically binding for creditors holding the remaining 25 per cent of the credits provided that all creditors have been duly informed about the procedure and all creditors belonging to the same category are treated pari passu.

Compulsory administrative liquidation

Compulsory administrative liquidation is an administrative procedure controlled by state officers instead of by the courts. The procedure is used when the debtor’s business is deemed to be of public interest, such as insurance companies, banks, cooperatives and non-profit entities, which are subject to a number of governmental controls. The purpose of this procedure is to achieve recovery of the business through a settlement or an arrangement plan. The debtor, the directors of the debtor company and any of the creditors are entitled to apply to the court in order to start the procedure. The court is under the obligation to seek the advice of the governmental agency responsible for supervising the debtor’s enterprise. The judge may initiate the proceedings by declaring the insolvency of the debtor and appointing a liquidator. All legal actions by creditors against the debtor are then suspended, with the exception of those aimed at ascertaining the amount of the claim. The liquidator, who also acts as a public officer, is assisted by a supervisory committee consisting of a number of experts, whose number can vary from three to five and who are not required to be creditors of the debtor (even if this might be preferable). Unlike in other insolvency proceedings, there is no requirement for a judge or a commissioner to be in charge. The liquidator must review the claims and evaluate whether the settlement plan is feasible.

Extraordinary administration

The extraordinary administration procedure applies to big companies falling within certain specific requirements, the occurrence of which is checked by the relevant court where the request for the extraordinary administration procedure is filed. The procedure applies to companies employing no less than 200 employees for at least one year, and having an overall amount of debt, the value of which is no lower than two-thirds of the aggregate value of both assets and revenues. For the application of the extraordinary administration, the company must have ‘concrete chances for the recovery of its financial stability’. After consultation with the Ministry of Economic Development and the Ministry of Economy, the court issues an order declaring the insolvency of the company. The Ministry of Economy appoints an
‘extraordinary commissioner’, who proposes a plan for the disposal of the assets or a recovery plan within 60 days of his or her appointment. All legal actions initiated by creditors against the company are suspended as a consequence of the foregoing order. Special variances of the extraordinary administration procedure apply to (1) large companies employing no less than 500 employees in the year preceding the filing of the relevant petition and having a total amount of debts amounting to, or exceeding, €300 million, as well as (2) large companies operating in strategic public services.

ii  Duties of directors of companies in financial difficulties

According to the provisions of the Italian Civil Code, the directors of a company must act with a duty of care, avoid conflicts of interest and comply with the law and the company’s by-laws in the day-to-day management of the company. In all cases, the directors are jointly liable if they fail to adequately supervise the general conduct of the company’s affairs or if, being aware of prejudicial acts, they do not act in order to prevent any harmful activities, or to eliminate or reduce the harmful consequences of such activities. Liability for acts or omissions of directors does not extend to those directors that, acting without fault, express their dissent without delay, such dissent being registered in the minute book of the meetings and resolutions of the board of directors, with written notice also to the chair of the board of auditors. Again, according to the Italian Civil Code, directors are held liable to the company’s creditors for non-compliance with their duties concerning preservation of the company’s assets. The action can be brought by creditors when the company’s assets prove to be insufficient to satisfy their claims. In the event of bankruptcy or compulsory administrative liquidation, the action against the directors can be brought by the receiver in bankruptcy or by the commissioner. A waiver of the action by the company does not prevent the company’s creditors from exercising their legal rights against the directors.

iii  Bankruptcy claw-back actions

Transactions carried out by a debtor prior to the date of the bankruptcy declaration may be subject to claw back under the Insolvency Act upon certain conditions. The ‘suspect period’ varies from one year to six months prior to the bankruptcy declaration depending on the nature and characteristics of the scrutinised transaction. In the event the bankruptcy declaration occurs after the filing of a petition of a **concordato** procedure, the suspect period commences on the day in which the petition was published in the company register.

In particular, the following transactions are subject to claw back unless the other party proves that it was not aware that the debtor was insolvent at the time of transaction:

- **a** transactions for consideration carried out in the one-year period preceding the declaration of bankruptcy if the obligations assumed by the insolvent party exceed by more than one-quarter the paid or agreed consideration;
- **b** transactions extinguishing payable pecuniary debts carried out in the one-year period preceding the declaration of bankruptcy if the debt repayment was not made in cash or by other normal payment methods;
- **c** pledges, **anticresi** and voluntary mortgages perfected on the debtor’s assets during the one-year-period preceding the declaration of bankruptcy to secure prior debts that were not overdue at the time when the security interest was perfected; and
- **d** pledges, **anticresi**, voluntary and judicial mortgages (mortgages created by an order of the court) perfected on the debtor’s assets during the six-month period preceding the declaration of bankruptcy to secure overdue debts.
Furthermore, transactions in the ordinary course of business carried out in the six-month period preceding the declaration of bankruptcy may be clawed back if the receiver proves that the other party was aware that the debtor was insolvent at the time of transaction. 2

III RECENT LEGAL DEVELOPMENTS

i Legislative Decree No. 14, dated 12 January 2019

The Legislative Decree No. 14, dated 12 January 2019, introduced the new Code of the Business Crisis and Insolvency (the New Code) that will be implemented in full in 2020. However, from 16 March 2019, certain provisions are already in force that are considered functional to the new reform process (see Section VI).

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

It is worth mentioning that when dealing with distressed companies, either as an investor, debtor or creditor, special attention must be paid to Law Decree No. 231 of 8 June 2001 (Law 231), which concerns the administrative liability of legal entities, companies and associations without legal capacities, and the consequences of its violation by the company.

In particular, the application of Law 231 becomes more important when the distressed situation of the relevant company is a consequence of (or simply occurs in the context of) the commission by the entrepreneur (or by the board of directors) of specific crimes. Committing those crimes can trigger the submission of the company itself to certain sanctions, including the confiscation of the company’s properties, if the company did not create a system capable of protecting itself from the negative consequences of committing those crimes by physical individuals operating in the name or on behalf of the company. Therefore, in evaluating a business opportunity, the investor has to take into account any possible consequences in the event that a violation of Law 231 has been charged to the company. In fact, the creditor’s right to be satisfied by the company’s assets or the company’s right to recover from the distressed situation (sometimes) thanks to the intervention of a third-party investor could be overridden by the state’s interest in confiscating all (or part of) the assets of the company, to the detriment of creditors and all other interested parties. According to a recent decision of the Supreme Court, this principle, according to which the interest of the state has priority over the interests of the creditors, has been slightly overridden, to the benefit of the creditors and the company. This decision is quite important and it would be suitable for a provision of law to be implemented to confirm these principles.

V INTERNATIONAL

The Regulation (EU) 2015/848 (the Regulation), which applies from 26 June 2017 with a few exceptions among Member States, has introduced the following:

a Article 1 provides that the Regulation applies to ‘public collective proceedings, including interim proceedings’, aiming at the rescue, the completion of a debt restructuring agreement, the company reorganisation or the company assets liquidation;

2 Article 67 of the Royal Decree No. 267/1942 (Insolvency Act).
the rules regulating the applicable jurisdiction and the centre of main interest are now defined by the Regulation as ‘the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties’ and the national courts are now allowed to claim the jurisdiction in the event ‘the company’s actual centre of management and supervision and of the management of its interests is located’ within its territory, and ascertain _ex officio_ the correctness of the jurisdiction;

it is now possible to suspend or refuse secondary insolvency proceedings in the event of contrast with a connected insolvency procedure dealt by another Member State;

an international network for the insolvency databases has been created; and

a duty of cooperation between different Member State courts has been introduced in case of insolvency proceedings regarding two or more companies’ part of the same group.

**VI  FUTURE DEVELOPMENTS**

As stated above, a broad and innovative reform has been introduced with the New Code. The New Code will enter into force in its entirety in August 2020, except for the regulations which introduce amendments to the Italian Civil Code and which, although they do not regulate purely bankruptcy aspects, are functional to the reform process.

The New Code has the scope of bringing together all relevant laws concerning the crisis, together with significant changes to the current law system. The fundamental goal of the New Code is to highlight as soon as possible the symptoms of a business crisis through the provision of warning systems, accompanied by the introduction of a body for the composition of corporate crisis (OCRI), to be set up at the various chambers of commerce, to which the control bodies of the companies and qualified public creditors (such as the Revenue Agency, National Social Security Institute and Collection Agent) shall have to report anomalous situations that emerge from the application of certain indicators of the crisis (imbalances of an income, equity or financial nature), related to the specific characteristics of the company and the entrepreneurial activity carried out by the debtor.

The provisions of the New Code regulate the state of crisis and insolvency of any debtor, including consumers, professionals and entrepreneurs of any size and nature, including agricultural ones, operating as a natural or legal person or other collective body, group of companies or public companies, with the exclusion of public bodies only.

The most important novelty of the reform is the replacement of the bankruptcy with the ‘judicial liquidation’, aimed at liquidating the assets of the insolvent entrepreneur and distributing the proceeds in favour of creditors on the basis of the gradation of their receivables (pre-deductible receivables, secured receivables and unsecured receivables). This procedure is, however, to be considered as an extreme measure, since the main objective of the legislator is to help the company in crisis to recover.

In this context, the alert procedures play an important role and have been introduced by establishing in each chamber of commerce a body responsible for the management of the business crisis (OCRI) to assist the debtor during the procedure. Furthermore, the New Code has introduced a special procedure for the assisted settlement of the crisis, which is aimed at seeking a solution through negotiations with creditors carried out with the mediation of the OCRI and the regulation of reward measured (financial and legal) for debtors that self-report the circumstances of the crisis facing their company in a timely manner, that is, within six months of the occurrence of certain crisis indicators.
Another novelty of the reform is the express recognition of the institution of a group of companies, whose fundamental prerequisite is the effective management and coordination activity carried out by the parent company. The current legislation does not allow a group of companies to be treated as a single entity, and considers each company an autonomous legal entity. A new set of rules is therefore laid down that, for groups of companies, provides for a uniform procedure before the company’s court for access to the various procedures.
I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

Situated at the crossroads between Belgium, France and Germany, Luxembourg is a highly stable country and has registered relatively consistent growth rates in the last two years with a GDP growth of 2.8 per cent in 2018 (compared to 2.3 per cent in 2017). Economists also forecast a GDP growth rate of 3.0 per cent in 2019.²

In Luxembourg, bankruptcy proceedings are currently the most common insolvency proceedings, while reorganisation proceedings remain rarely used in practice or are often used too late to avoid bankruptcy. However, a substantial reform of Luxembourg insolvency law is underway (see Section VI.ii).

In 2018, the number of bankruptcy proceedings remained relatively stable with a total of 1,086 judgments (compared to 988 in 2017).³ In contrast, approximately 947 bankruptcy proceedings were opened by the Luxembourg District Court during the first half of 2019, thus reflecting a considerable upward trend in 2019.⁴

In this context, the business sector most affected by the high bankruptcy ratio is the services sector.⁵ These figures reflect the structure of Luxembourg’s economy, which is still led by the banking and financial sector. Around 150 credit institutions are established in Luxembourg. Some multinational companies, such as ArcelorMittal, Goodyear, DuPont, SES or Ferrero have chosen to successfully establish their European headquarters in Luxembourg. In recent years, multinational companies active in the high-tech and e-commerce industries have also decided to set up their European or international headquarters in Luxembourg.

Regarding Luxembourg reorganisation proceedings, few were opened in 2018. Only two controlled management proceedings were opened in 2018, and one was followed by a bankruptcy proceeding.⁶

After the 2007–2008 crisis, proceedings were opened against several credit institutions with established subsidiaries or branches in Luxembourg, including among others some Icelandic banks (Kaupthing, Glitnir Bank, Landsbanki) as well as Lehman Brothers and Espirito Santo.

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¹ Clara Mara-Marhuenda, Sébastien Binard and Grégory Minne are partners at Arendt & Medernach.
⁴ These statistics only include bankruptcy judgments rendered in relation to commercial companies.
II GENERAL INTRODUCTION TO THE RESTRUCTURING AND
INSOLVENCY LEGAL FRAMEWORK

The Luxembourg legislative framework makes a distinction between proceedings involving
the winding up of the debtor (bankruptcy proceedings),7 and proceedings aiming at the
reorganisation of the debtor (controlled management,8 composition with creditors to avoid
bankruptcy9 and stay of payments).10

Of the above, controlled management is the most-used reorganisation proceeding. Stay
of payments and composition with creditors have rarely been used successfully in the past
decades.

It must be added that specific insolvency regimes govern credit institutions, insurance
undertakings and investment funds, for example:

a the amended law of 18 December 2015 on the resolution, reorganisation and
winding-up measures of credit institutions and certain investment firms;
b the amended law of 7 December 2015 on the insurance sector;
c the amended law of 17 December 2010 relating to undertakings for collective
investment (UCIs);
d the amended law of 13 February 2007 on specialised investment funds;
e the amended law of 12 July 2013 on alternative investment fund managers;
f the law of 23 July 2016 on reserved alternative investment funds; and
g the amended law of 15 June 2004 relating to the investment company in risk capital
(SICAR).

i Winding-up proceedings

Bankruptcy

Conditions for opening

Debtors who carry out commercial activities and who make a profession out of these activities
may be declared bankrupt.

Two conditions have to be met cumulatively for a trader to be considered bankrupt11:
(1) it can no longer pay debts as they fall due (i.e., he or she is in a situation known as
cessation of payments); and (2) he or she is no longer being granted credit.12

The cessation of payments means the debtor is unable to meet its commitments.13
It implies that unpaid debts are certain, liquid and have fallen due on the day on which
the bankruptcy judgment is delivered.14 It is not necessary that the debtor has ceased all its
payments. The only relevant issue is to establish whether the default in payment to certain

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7 Articles 437 ff. of the Commercial Code.
8 Grand Ducal Decree of 24 May 1935 on controlled management.
9 Law of 14 April 1886 on composition with creditors, as amended.
10 Articles 593 ff. of the Commercial Code.
11 The article focuses on insolvency proceedings related to commercial companies.
12 Article 437 of the Commercial Code.
13 Novelles, Droit commercial, T.IV , No. 203, p. 72.
14 Court of Appeal, 5 December 2012, docket No. 38410.
creditors is temporary or permanent. In the latter case, the existence of a single debt may lead to the cessation of payments.\textsuperscript{15} Conversely, temporary financial difficulties would not be sufficient.\textsuperscript{16}

The loss of creditworthiness may result from the inability to raise credit or from the creditors’ refusal to accept any further delay in paying back the debt.\textsuperscript{17}

\textit{Procedure}

The district court with jurisdiction may declare the debtor bankrupt upon the request of: (1) one or more creditors; (2) the public prosecutor; (3) upon the declaration of the cessation of payment by the debtor itself; or (4) \textit{ex officio} by the court.

The proceeding is carried out by a receiver under the supervision of a bankruptcy judge, who are both appointed in the bankruptcy judgment. The receiver will have the judgment published in summary in the newspapers designated by the court.

The receiver represents both the debtor and the body of creditors.

The receiver prepares an inventory of all of the debtor’s assets. If it appears that the assets are insufficient to cover the costs of the bankruptcy proceeding, the court may upon request of the receiver decide to end the proceeding immediately.

All creditors have to lodge a proof of their claim with the district court. The receiver decides together with the bankruptcy judge whether the declared claims have to be accepted or not. Creditors whose claims have been rejected may refer to the district court for judgment.

All assets of the debtor are realised either by private contract or by public auction as ordered by the court. The receiver seeks to obtain payment of all outstanding claims of the debtor.

The receiver administers and realises the debtor’s assets and distributes the proceeds among the creditors on the basis of their rank and after the administrative costs and fees of the receiver are paid.

After all proceeds have been distributed among the creditors, the receiver submits a detailed report about the bankruptcy proceeding.

\textit{Effects}

Upon the bankruptcy judgment, the debtor is no longer entitled to administer its assets or dispose of them. Any legal actions taken by unsecured creditors against the debtor are suspended. Certain preferential creditors are allowed to continue the proceedings they have initiated. Creditors benefiting from financial collateral arrangements or set-off and netting arrangements may exercise their rights (see Section II.iv).

The district court determines a hardening period (or suspect period), which covers the situation where the debtor, before having been declared bankrupt, was unable to meet its financial obligations and during which ‘abnormal’ transactions performed by the debtor may be declared void. Such clawback actions will be discussed below. In practice, the district court usually sets the hardening period to the legal maximum of six months prior to the bankruptcy judgment.

\textsuperscript{15} District Court of Luxembourg, 14 May 2004, docket No. 75935.
\textsuperscript{16} Court of Appeal, 20 February 1934, Pas. 13, p. 268.
\textsuperscript{17} Court of Appeal, 12 November 2014, Pas. 37, p. 340.
Agreements entered into by the debtor are not automatically terminated, with the exception of *intuitu personae* agreements, employment agreements and those including an insolvency termination clause. Generally any business activity of the debtor is stopped, but in certain cases the receiver may decide to continue the business temporarily.

After bankruptcy proceedings have started, the debtor can propose a composition to its creditors. Proposals of composition after bankruptcy proceedings have started are, however, exceptional.

**ii  Reorganisation proceedings**

*Composition with creditors to avoid bankruptcy*

**Conditions**

Composition with creditors is a protective measure that allows debtors in financial difficulties to avoid the declaration of bankruptcy, through the approval by the district court of an arrangement with its creditors for the settlement of their claims. As in bankruptcy matters, companies may benefit from the composition with creditors proceedings, provided that they are considered as acting in good faith and unfortunate.

**Procedure**

The debtor files the request before the district court with jurisdiction. The petition contains, among others: (1) a description of the events that have led to the financial difficulties; (2) a detailed evaluation of the debtor's assets; (3) a list indicating the names of its acknowledged or alleged creditors, their address and the amount of their claims; and (4) the composition proposal.

Subject to the request's admissibility, the district court appoints a delegated judge to establish a report of the situation of the debtor. However, should the court consider that the procedure is hopeless, it may order the bankruptcy *ex officio*. If the court approves the composition proposal, it sets a date for a meeting of creditors. The debtor must deposit a sum to cover the costs to be incurred for the publication of the notice to attend the meeting of creditors.

At the meeting of creditors, the delegated judge reports on the state of the affairs of the debtor and the debtor proposes an arrangement to its creditors. The composition can only be approved with the approval of the majority of the creditors (representing 75 per cent of the total claims accepted definitely or provisionally). Creditors whose claims are secured by a lien, a pledge or mortgage are not entitled to vote with regard to their claims unless they waive their lien, pledge or mortgage. Following the meeting with creditors, the court convenes a hearing for the final approval of the arrangement.

The judgment approving the composition (or not) is issued and, within three days, it is posted in the auditorium of the court and published in summary form in the designated newspapers.

**Effects**

Once approved, all enforcement measures are temporarily suspended subject to financial collateral arrangements, and set-off and netting arrangements (see Section II.iv). The arrangement is binding upon all creditors but only applies to liabilities incurred or commitments made before such arrangement.
An appeal or objection by the creditors or the debtor against the judgment approving the composition (or not) has no suspensive effect.

**Stay of payments**

**Conditions**

Stay of payments may be granted to the debtor, who has suffered temporary liquidity problems, allowing it to suspend payments to creditors for a given period of time. It may be granted either: (1) if the debtor, due to exceptional and unforeseen events, has to temporarily cease its payments but the verification of the balance sheet shows that it has sufficient assets or income to satisfy the creditors in principal or interest; or (2) if the debtor is currently in deficit but there are strong indications that it may rebalance its assets and liabilities (i.e., return to solvency).

**Procedure**

The request, accompanied by a description of the events on which the request is based, a list of the creditors and a detailed estimate of the debtor’s assets and liabilities, is filed by the debtor simultaneously before the district court and the Supreme Court.

The district court appoints one or more experts to examine the affairs of the debtor and a judge to supervise the operations.

The judge will hand down his or her report in the presence of the creditors convened on the date (within 15 days of the request) set by the president of the district court. On such date, the creditors are heard, they declare the amount of their claims and decide whether they approve or reject the request for stay of payments.

The stay of payments may only be granted with the approval of the majority of creditors representing three-quarters of the aggregate debt.

After the meeting of the creditors, the district court hands down its opinion, which is transmitted, together with the relevant documents, to the attorney general of the Supreme Court.

The Supreme Court hands down its decision within eight days. If the Supreme Court grants a stay of payments, it determines its duration and appoints one or more commissioners.

**Effects**

The management body of the debtor stays in place during the stay of payments but acts under the supervision of a commissioner. The creditors’ rights are suspended for the duration of the proceeding subject to financial collateral arrangements, and set-off and netting arrangements (see Section II.iv). The stay of payments only applies to the commitments entered into before such stay of payments was granted.

**Controlled management**

**Conditions**

A company that is either: (1) not able to raise additional credit; or (2) has difficulties meeting its commitments may apply to the district court for an order for controlled management, under which the management of the debtor is placed under the control of one or more commissioners designated by the court. A debtor cannot avail itself of the controlled management regime if it is already considered bankrupt (i.e., if the two conditions for bankruptcy referred to above are met).
**Procedure**

The application for controlled management, accompanied by a list of the creditors and evidence that the prospects for reorganisation (or orderly liquidation) are realistic, is filed *ex parte* by the debtor before the district court. Only the debtor has standing to seek controlled management and such proceeding may not be initiated by a third party (e.g., a creditor or a shareholder).

The purpose of controlled management is to allow either a reorganisation or an orderly winding up of the debtor through the realisation and distribution of its assets.

Upon the filing of the application, unless the financial situation of the debtor appears to be hopeless, the district court issues a first judgment including the appointment of a delegated judge to examine the debtor’s affairs and to report to the court. If the debtor’s prospects for reorganisation (or orderly liquidation) are not realistic, bankruptcy will be the only alternative.

If the court comes to the conclusion that a reorganisation (or orderly liquidation) is possible, it will grant the application for controlled management and appoint one or more commissioners who have to submit a reorganisation plan or a plan regarding the realisation and distribution of the debtor’s assets.

The judgment of the court is issued from the delegated judge’s report, after having heard the debtor (excluding the creditors). The court’s judgment will be published in summary form for the information of all creditors.

The commissioners will report to the court and submit a reorganisation (or a liquidation) plan, depending on the financial capacities of the debtor. The plan shall determine:

- whether unsecured creditors’ claims will be paid in full or in part, with or without further rescheduling; and
- whether interest accruing after the date of the judgment delegating a judge or the controlled management decree will be due.

The content of the commissioners’ proposal is individually notified to the debtor’s creditors and also published by extract on RESA, the Luxembourg central electronic platform of official publications officially named the ‘Recueil électronique des sociétés et associations’.

The creditors shall vote within 15 days of the notification and the publication on the reorganisation or liquidation plan, which, upon approval of a majority of creditors representing more than half of the debtor’s aggregate debt, and the court’s consent, will be binding upon the debtor and all creditors. The debtor or its creditors may appeal against the court’s judgment to accept or reject the plan agreed to by a majority of the creditors. The court’s judgment approving the plan is, however, provisionally enforceable pending the outcome of the proceedings in the Court of Appeal.

Creditors may submit observations to the court before it takes its decision to accept or reject the plan. Creditors abstaining from the vote are deemed to have voted in favour.

Once the plan has received final approval, its content is applicable and binding upon the debtor and all its creditors, whether in agreement or not. If, however, the plan is rejected by the creditors or by the court, the court either pronounces bankruptcy or allot further time to the commissioner for the submission of an alternative plan.

All debts of the debtor originating before the date of designation of a delegated judge by the first judgment of the district court are taken into consideration. Further debts, duly authorised by the judge and, afterwards, by the commissioner, which are incurred during the mission of the delegated judge and of the commissioner, may also be taken into consideration in the plan.
If the plan is approved by the creditors and the court, the debtor in principle regains control over its affairs. Otherwise, bankruptcy proceedings will normally be instituted.

**Effects**

The commissioner does not replace the debtor’s management but supervises it. The decisions taken by the debtor’s management must be approved by the commissioner or should be otherwise voidable. In addition, the commissioner may initiate proceedings to void any ‘abnormal’ transactions (such as preferential payments) made by the debtor within a period of up to six months and 10 days prior to the application for controlled management. They may also initiate liability actions for mismanagement against the directors.

As from the court’s judgment, enforcement rights of the creditors against the debtor’s assets are suspended (subject to financial collateral arrangements, and set-off and netting arrangements (see Section II.iv)) and any voluntary payments from the debtor require the prior authorisation of the delegated judge.

Subject to the foregoing, creditors’ enforcement rights remain suspended for the duration of the controlled management. Depending upon the wording of the court’s judgment, they may have to submit their proof of claim.

**iii Informal (out-of-court) restructuring**

There is currently no legal framework in Luxembourg for an out-of-court debt restructuring, such as standstill, debt rescheduling, new money financing, debt-to-equity conversion or takeover of debtor by creditors. However, the debtor may enter into out-of-court arrangements with its creditors.

**iv Specific topics**

**Taking and enforcing financial collateral, set-off and netting**

The amended law of 5 August 2005 on financial collateral arrangements (the Collateral Law), implementing Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, provides exceptional protection to collateral takers in the case of reorganisation or winding up of the collateral giver. In substance, where a financial collateral arrangement (i.e., pledge agreement, transfer of title for security purposes agreement, repurchase agreement and fiduciary transfer agreement) is subject to the Collateral Law, Luxembourg insolvency provisions (where the collateral giver is in Luxembourg) or foreign law insolvency provisions (where the collateral giver is not in Luxembourg) are not applicable, thus enabling the collateral taker to enforce its rights notwithstanding the reorganisation or winding up of the collateral giver.18

Under the Collateral Law, set-off and netting arrangements (under which the parties agree to set off their mutual obligations) with respect to claims or financial instruments are also enforceable notwithstanding the existence of Luxembourg or foreign reorganisation or winding-up proceedings initiated against the defaulting party.

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18 Article 20(4) of the Collateral Law.
**Duties of directors of companies in financial difficulties**

**General principle**

As a general principle, the directors of a Luxembourg company are not liable for the debts incurred by that company. However, the directors' general duty is to perform their duties in the best interests of the company, and they may be held liable if they failed to act in a prudent and diligent way and caused damages to the company (contractual liability) or to third parties (tort liability). In case of bankruptcy, the receiver, who represents both the company and the body of creditors, may initiate liability actions against the directors.

**Specific provisions**

The amended law of 10 August 1915 on commercial companies (the Companies Law) includes specific provisions on the duties of directors of Luxembourg companies in financial difficulties.

If as a result of a loss, the net assets of a company are reduced to an amount that is less than half of its share capital, the board of directors shall convene a shareholders’ general meeting to deliberate on the possible dissolution of the company. In the event of a breach of this provision, the directors may be declared personally jointly and severally liable towards the company for all or part of the increase in the loss.

The Companies Law provides for specific criminal offences, such as the failure to publish the balance sheets and compulsory reports or the payment of fictitious dividends. The main legal provisions dealing with the personal liabilities of directors in case of bankruptcy are laid down in the Commercial Code.

The directors must file for bankruptcy within one month from the date that the company has ceased its payments. Failing that, they may be criminally liable for negligent or fraudulent bankruptcy.

If a director has contributed by a serious offence to the bankruptcy of the company, the court may declare that such director shall be prohibited from exercising directly or indirectly any commercial activity as well as any function of director, manager, auditor or any function implying the power to undertake obligations on behalf of a company.

Any director may be declared personally bankrupt in case of bankruptcy of a company, if he or she has used the company to act in his or her personal interest; has used the company's assets as if they were his or her own; or has carried on, in his or her personal interest, any

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19 Article 441-8 (ex-58) of the Companies Law.
20 Article 441-9 (ex-59), Section 1 of the Companies Law provides for the personal and individual liability of a director towards the company for management errors. Article 441-9 (ex-59), Section 2 provides that a director shall be liable to the company and third parties in the event that the company or third parties suffer a loss due to a breach of either the law on commercial companies or the company's articles of incorporation.
21 Article 480-2 (ex-100) of the Companies Law, only applicable to public limited companies and partnerships limited by shares.
22 Article 1500-2 (ex-163) of the Companies Law.
23 Article 1500-6 (ex-167) of the Companies Law.
24 Article 440 of the Commercial Code.
26 Article 444-1 of the Commercial Code.
loss-making activity that would inevitably lead the company into bankruptcy.\textsuperscript{27} It makes no difference whether the director has been lawfully appointed by the company or has acted in such capacity.

The court may decide that the directors of a company are liable for the outstanding debts of that company, if gross negligence by the directors has contributed to the bankruptcy and if the assets of the company do not allow the payment of all the company’s creditors. Such gross negligence is appreciated in concreto by the court.

The same liability applies in cases where one or several directors have misused their authority in order to continue any loss-making activity of the company, for their own personal benefit and without taking reasonable measures to avoid bankruptcy.

The above rule does not only apply to directors who are in office at the moment the company is declared bankrupt but may also apply to any directors that have in the past contributed to the bankruptcy through their actions, to lawfully appointed or to de facto directors.

\textit{Clawback actions}

Any payments made or transactions concluded by the management of the debtor, but not by the receiver, during the bankruptcy proceedings, are null and void.

Moreover, the Commercial Code provides for specific rules applicable to transactions entered into by a debtor who has been declared bankrupt during the hardening period or made to defraud the rights of creditors, regardless of the hardening period. These rules do not apply to financial collateral arrangements, and set-off and netting agreements subject to the Collateral Law.

\textit{Transactions concluded during the hardening period}

Without prejudice to the arrangements subject to the Collateral Law, the following transactions are automatically null and void if concluded by the debtor during the hardening period or during the 10 days preceding the hardening period: any transaction pertaining to the transfer of assets without consideration or where the consideration received by the debtor is notably insufficient; any payment made in respect of debts that have not yet matured; any payment made by any other means than cash or trade bills in respect of matured debts; the creation of any contractual or judicial mortgage and the granting of any pledge on any asset of the debtor in order to secure preexisting debts.\textsuperscript{28}

Any other payment made by the debtor for any matured debt and any transaction for consideration entered into during the hardening period may be declared null and void if the counterparty of the debtor had due knowledge of the fact that such debtor was in cessation of payments at that time.\textsuperscript{29}

The action seeking a declaration of invalidity or annulment of a transaction by the court may only be brought by the receiver, who represents the body of creditors.\textsuperscript{30}

\textsuperscript{27} Article 495 of the Commercial Code.
\textsuperscript{28} Article 445 of the Commercial Code.
\textsuperscript{29} Article 446 of the Commercial Code.
\textsuperscript{30} Luxembourg District Court, 28 May 1925, Pas. 11, p. 206.
Transactions made in violation of the rights of creditors, regardless of the hardening period

Without prejudice to the arrangements subject to the Collateral Law, any transaction or payment made to defraud the rights of the creditors of a debtor is null and void, irrespective of the date on which it occurs.\(^{31}\)

The receiver may challenge any fraudulent payments and transactions made prior to the bankruptcy, regardless of the hardening period, subject to proof that the creditors suffered a loss and that the transaction was made by the debtor to defraud the rights of its creditors.

III RECENT LEGAL DEVELOPMENTS


The law provides for measures for early intervention and the resolution of credit institutions and some investment firms, either on an individual or a group basis, and designates the Luxembourg financial regulator (i.e., CSSF) as the resolution authority for Luxembourg. The main resolution tools granted to the resolution council are: (1) the sale of businesses by competent authorities without shareholder consent; (2) the creation of a bridge institution; (3) an asset segregation allowing for a transfer of toxic assets to a ‘bad institution’; and (4) a bail-in.

The law also provides for the reorganisation and winding up of credit institutions, investment firms and other professionals of the financial sector.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

As set out in the introductory section, 2018 saw a small increase in the number of bankruptcies in comparison with 2017. The sector most affected by bankruptcies was the services sector.\(^{32}\)

In September 2016, Telecom Luxembourg Private Operator was placed under controlled management and avoided bankruptcy through its acquisition by the French NomoTech Group, through its Luxembourg subsidiary LuxNetwork SA.\(^{33}\)

V INTERNATIONAL

In the context of cross-border insolvency proceedings, Regulation 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the New Insolvency Regulation) applies to insolvency proceedings opened as from 26 June 2017.

\(^{31}\) Article 448 of the Commercial Code.
The New Insolvency Regulation replaces the Regulation 1346/2000 of the Council of 29 May 2000 on insolvency proceedings (the Old Insolvency Regulation) as from 26 June 2017. The Old Insolvency Regulation continues to apply to insolvency proceedings that were opened before 26 June 2017.

Without going so far as to completely change legislation that has already proved its worth, the New Insolvency Regulation contains substantial innovations intended to make up for the deficiencies of the Old Insolvency Regulation and to take into account the development of international insolvency law.34

Like the Old Insolvency Regulation, the New Insolvency Regulation defines a legal framework for cross-border insolvency proceedings as it governs in particular issues linked to jurisdictional competence, the recognition of insolvency proceedings and applicable law.

The New Insolvency Regulation also takes into account recent developments in the domain of insolvency by introducing substantial innovations, such as the extension of the scope of the rules to proceedings intended to rescue distressed debtors, the clarification of the notion of ‘centre of main interests’ (COMI) and the measures intended to combat forum shopping, the strengthening of relations between the main proceedings and secondary proceedings, the improvement of the treatment of creditors and the establishment of a regime for the treatment of the insolvency of groups of companies.35

The Luxembourg insolvency proceedings referred to in the New Insolvency Regulation are as follows:

\[\begin{align*}
a. & \text{ bankruptcy proceedings;} \\
b. & \text{ controlled management;} \\
c. & \text{ composition with creditors;} \\
d. & \text{ special winding-up regime applicable to notaries; and} \\
e. & \text{ procedures applicable to collective debt settlement in the context of over-indebtedness.}
\end{align*}\]

Stay of payments is excluded from the above list of Luxembourg insolvency proceedings.

VI FUTURE DEVELOPMENTS

i Directive

A proposal from the European Commission for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU36 was released by the end of 2016. The proposal aims to reduce significant barriers to the free flow of capital stemming from differences in the restructuring and insolvency frameworks of the Member States that should have in place key principles on effective restructuring and second chance frameworks, and measures to make insolvency proceedings more efficient by reducing their length and associated costs and improving their quality.

On 6 June 2019, the European Council adopted the Directive. The Member States have two years to adopt the proposed rescue tools into their own laws.

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35 ibid.
Future insolvency reform

A reform of insolvency legislation is currently in progress as a result from Draft Bill No. 6539 on business preservation and modernisation of bankruptcy law, dated 26 February 2013 (the Draft Bill). The Draft Bill is currently under analysis by several commissions within the parliament. On 6 March 2018, the Luxembourg government published a modified version of the Draft Bill further to opinions from various bodies, including the Council of State. The Draft Bill intends to provide new tools to distressed companies, its main objectives being the preservation of companies’ activities and the protection of the various stakeholders by favouring reorganisations over liquidations.

The Draft Bill distinguishes between court restructuring and out-of-court restructuring and is built around four guiding principles: a preventive aspect, a restorative aspect, a repressive aspect and a social aspect.

The preventive measures contained in the Draft Bill are designed to allow for the gathering of certain information from companies to identify those experiencing financial difficulties at a stage where they may still benefit from efficient reorganisation and out-of-court procedures (e.g., the conciliation process). The reorganisation measures to be made available to distressed companies also provide for instruments designed to preserve and reorganise business activities while taking the rights of creditors into account, which companies will be able to request on their own initiative.

The purpose of the repressive element of the Draft Bill is to prevent companies that act in bad faith from abandoning their business and starting a new one with impunity. The Draft Bill also introduces an administrative dissolution procedure without liquidation and aimed at eliminating ‘empty shells’ in a timely and cost-efficient manner by avoiding formal bankruptcy proceedings.

The Draft Bill finally includes a social aspect. As a matter of principle, all the rights and obligations resulting from employment contracts are transferred to the purchaser of the assets of the relevant distressed company.

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37 The last opinion was issued by the Chamber of Commerce on 14 March 2019.
38 Luxembourg 2009 governmental programme, p. 108.
39 If the viability of a company’s activities is threatened to the extent that it needs to adopt measures that can be enforced against third parties, the debtor would have the right to apply for a judicial reorganisation procedure with the relevant district court.
40 The reorganisation measures to be made available to distressed businesses under the Draft Bill encompass out-of-court procedures and judicial procedures, which are adapted to the size of the relevant business and are largely voluntary.
Chapter 15

MEXICO

Thomas S Heather

I       OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

The past 18 months have witnessed a flurry of litigation in the Mexican courts, which pursuant to the terms of the law of Commercial Insolvency of 2000, as amended in 2007 and 2014 (the Concurso Law), have exclusive jurisdiction in insolvency matters. While the actual number of filings – mostly voluntary – for relief under *concurso mercantil* remains modest with respect to major corporations experiencing liquidity issues, the continuing widespread use of pre-admission ‘precautionary’ or pre-emptive measures upon the filing of voluntary requests by debtors for *concurso* relief have generated complex litigation cases. The end result for the time being has been a constant and significant delay in *concurso* proceedings, and what appears to be a demise in the reliability of formal insolvency processes in Mexico.

Indeed, a prime example is the much publicised battle between the many parties involved in the cross-border proceeding of Mexican driller Oro Negro and the deterioration of the five state-of-the-art oil rigs sitting in Mexican waters formerly in its possession. There were well over 200 motions filed in the course of one year arising from controversies as to the extent and legality of precautionary measures issued by a federal court, which delayed the declaration of insolvent and thus the start of its *concurso* proceeding for over a year. Parallel filings were made in Singapore and in the Southern District of New York. In an interesting and unusual development, especially since the main proceeding is in a Mexican court, the judge overseeing the Chapter 15 case in New York ordered a 60-day mandatory mediation, which was conducted by an outstanding former US bankruptcy judge with the active participation of the Mexican conciliator. While the mediation failed to produce the basis for a restructuring agreement, it was in a way a success in establishing the realities of the case and its potential remedies. This US$1 billion-dollar case may well end in the liquidation of Oro Negro and ongoing litigation in the United States and Mexico.

Most other notable cases seem stalled in an overloaded court system – there are no special bankruptcy courts – with rotating judges in many instances. Delays of months are not uncommon and adherence to the ‘strict’ one-year statutory schedule for an orderly restructuring or conciliation is not complied with. A few cases, such as that of *Empresas ICA*, the largest restructuring to date, were resolved in record time. Nevertheless, they are the exception and most cases take a substantial time to be completed. It is clear that the Supreme Court lacks interest in overseeing the positive development of better practices in insolvency, given the many legal issues it is currently addressing, and, in addition the

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administrative body of the judiciary entrusted with the supervision of concurso proceedings, the Federal Institute of Specialists for Insolvency Procedures (IFECOM) has done very little to support the efficiency of conursos. Moreover, the federal judiciary, at the level of circuit courts, has continued to issue inconsistent and controversial decisions, which have added to the unreliability of the procedure.

A notable case involving a Spanish contractor’s Mexican subsidiary, ISOLUX, resulted in a successful restructuring using concurso as a tool, thanks to the tenacity of the Federal Electricity Commission, the creditor banks and the suppliers involved. This was even after the initial rulings of the court came dangerously close to derailing an orderly process that allowed for the rescue of certain strategic key infrastructure projects in power transmission.

In a further development, the policies implemented by the federal tax authorities to provide substantial relief consistent with court-approved plans, relief supported by specific provisions found in the Federal Tax Code, have come under fierce attack from the new administration of President López Obrador. If the provisions of the Federal Tax Code are repealed or policies overturned, there will be one less key incentive to using concurso mercantil as a restructuring tool.

In general, however, restructuring practices in Mexico continue to focus on out-of-court settlements with a very high rate of success. Making use of concurso mercantil as a means to implement solutions is the exception.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

As previously mentioned, the Concurso Law was published in May of 2000 and has been amended twice, in December 2007, with the introduction of the Mexican version of a pre-pack, and in January 2014, with the more significant amendments summarised in Section III.

The Concurso Law is a complex statute, which will require continued and hopefully, a careful application and interpretation by the Federal courts.

The following subsections present the principal aspects of the Concurso Law.

i One proceeding

The Concurso Law provides for one sole insolvency proceeding (concurso mercantil), encompassing two successive phases: a conciliatory phase of mediation among creditors and debtor (known as the conciliation stage), and a second stage of bankruptcy or liquidation. The objective of the conciliatory phase is to conserve the business enterprise as an ongoing concern through a restructuring agreement. On the other hand, the stated purpose of bankruptcy is to liquidate the business. Prior to a debtor being placed in concurso, the process includes a preliminary examination proceeding to verify whether the commencement standards have been met, unless a pre-pack is filed. Unfortunately, while the IFECOM formats are quite simple in their structure, the examination proceeding seems to be misunderstood as an audit of the company, leading to unexpected delays and confusion. It is noted that the initial preliminary proceeding lacks in transparency, and the examination proceeding reports are not made public.
ii  **Procedural terms**

An important part of the Concurso Law involves measures that were designed to expedite the handling of mechanical aspects of insolvency. Procedural terms in legal proceedings are relatively short, yet it is a fact that most courts fail to abide by them, although in the Empresas ICA case, the presiding judge did apply the terms strictly.

Provisions in the law as to procedural exceptions in legal proceedings were designed to avoid the automatic suspension of the conciliatory proceeding, as was the case under the prior Law of 1943, yet Federal judges continue to apply measures that have, in fact, halted concurso proceedings.

The conciliatory stage is designed to be completed in 185 calendar days in the best of cases, although two 90-day extensions may be granted if a qualified majority of creditors so approves. The Concurso Law clearly underlines that in no event may the conciliatory stage be extended beyond 365 days, whereupon bankruptcy and liquidation of assets are, in theory, to begin immediately. In practice, this is not the case.

iii  **Petition for commercial insolvency**

A business enterprise that is generally in default with respect to its payment obligations will be declared commercially insolvent. The debtor, any creditor or the Office of the Attorney General may file for insolvency.

The Concurso Law establishes precise rules that determine when a debtor is ‘generally in default’. The principal indications or presumptions are the failure by a debtor to comply with its payment obligations in respect of two or more creditors, and the existence of the following two conditions: 35 per cent or more of its liabilities outstanding are 30 days past due; and the debtor fails to have liquid assets and receivables, which are specifically defined, to support at least 80 per cent of its obligations, which are due and payable.

Specific instances, such as insufficiency of assets available for attachment or a payment default with respect to two or more creditors, are considered by the Concurso Law to be facts that by themselves will result in a presumption of insolvency.

In theory, the 2014 amendments allow the debtor to file for concurso if it can be anticipated that it will be generally be in default with respect to its payment obligations or falling within either of the conditions leading to a presumption of insolvency, as mentioned above, within 90 days of the petition filing. On the other hand, involuntary filings have been largely unsuccessful because of the many formalities that must be met.

iv  **Jurisdiction**

The federal courts have jurisdiction over concursos, notwithstanding that even this basic principle has been – unsuccessfully – challenged. While it is a fact that district judges are overburdened with constitutional challenges (amparos) and have little practice in regard to mercantile matters, the selection process, supervision, continued education and preparation of federal judges have been substantially improved in the recent past. Salaries have been materially increased, and there has been a greater impartiality. Nevertheless, the courts have been reluctant to accept insolvency cases given their considerable workload, among other reasons, and when they have accepted a major matter, the mere size and thousands, if not millions, of pages involved have made it a huge task to address and preside over these proceedings efficiently.
v Experts
The Concurso Law provides for the use and training of experts in the field of insolvency with IFECOM as an entity to coordinate their efforts and provide continuing education.

The specialists who have a role in proceedings under the Concurso Law are:

a the examiner, whose duties are to determine whether the debtor complies with the commencement standards and who participates in the proceeding up to the judge’s declaration of insolvency;  

b the conciliator, who is appointed in such declaration and who has broad powers to mediate, to take steps to protect the enterprise as an ongoing concern or to immediately begin bankruptcy and who takes on significant responsibilities in a concurso; and  

c the receiver, who may or may not be the conciliator and whose principal function is to proceed with the sale of assets and payment of claims.

The judge also has a principal role, although the function of the mediator or conciliator is considerable (including the authority to approve DIP financing).

Those who wish to act as examiner, conciliator or receiver must request IFECOM to register them in the special registry maintained by IFECOM. It is unfortunate that the registry, especially for complex cases, has not been opened for the large accounting or insolvency advisory firms, but only to individuals.

There are numerous restrictions prohibiting conflict-of-interest relationships. The appointment procedure is supposedly based on a random, electronic selection from the classes and ranges of experience pertaining to the experts registered with IFECOM, classes that vary in accordance with the complexity and asset size of the business enterprise in question.

It is relevant to note that a qualified majority of creditors may replace or appoint a professional as conciliator or receiver even if the professional is not registered with IFECOM. In cases involving the insolvency of a company operating under a federal concession, the conciliator may be appointed at the request of the corresponding authority, such as the Ministry of Communications in regard to corporations in the telecommunications industry, as was the case with the successful restructurings of Satélites Mexicanos SA de CV.

vi Related companies
Insolvency proceedings of two or more entities are not joined, although controlling and controlled companies’ proceedings will be joined, but will be handled in separate records. A petition must be filed individually by each group member; nevertheless, the 2014 amendments introduced provisions to allow for the joint petition by multiple group members. This technique was efficiently applied in the Empresas ICA case. Mexican courts do not, however, recognise substantive consolidation.

vii Identification of creditors and declaration of insolvency
The debtor that requests a judgment of declaration of concurso mercantil must furnish detailed lists of creditors and debtors, with a description of the nature of the debts. The

2 Although the 2014 amendments introduced the possibility of avoiding the ‘visitation stage’ in pre-packed filings, thus saving weeks of bureaucracy, the author is of the view that there could be a benefit of having an examiner complete the many IFECOM formats that may prove to be advantageous in the ongoing proceeding.
amendments of 2014 introduced a number of relevant additions to the petition request: a copy of the corporate resolutions that approved the filing, a proposed reorganisation plan and an enterprise conservation plan, which were intended to include DIP financing terms.

Absent a pre-pack, the day after the judge admits the petition, which in practice may take weeks or months, he or she must send a copy to IFECOM, ordering it to designate an examiner within five days. The judge will order the visit and immediately notify the debtor. The examiner will review the books and records of the debtor and will prepare minutes of the visit, which must also include a list of all creditors in IFECOM formats. The examiner may request that the judge issue precautionary measures needed to preserve the assets of the debtor, although the debtor’s counsel usually addresses them upon filing. The examiner will render a report to the judge that will be sent to the debtor and the creditors for their respective comments, if any.

Within a maximum term of 83 days as of the termination of the examination proceeding, the Law provides that the judge must render a judgment of mercantile insolvency, which, among other things, must contain:

- an order to IFECOM to appoint a conciliator;
- a declaration of the opening of the conciliatory stage unless the debtor has requested bankruptcy;
- an order to the debtor to deliver all books and records to the conciliator;
- an order to the debtor to suspend the payment of its pre-petition indebtedness, other than those that are deemed to be essential for the continuation of the business enterprise;
- an order to freeze all asset foreclosure and attachment proceedings; and
- an order to publish a notice to all creditors, so that they may appear in the proceeding, although this requirement (a filing proof of claim) is no longer mandatory.

The extensive participation of the conciliator in the proceedings should also be noted. The conciliator is also responsible for proposing the creditors who should be recognised and is mandated to proceed with notices and publications pursuant to provisions that are very specific as to terms. Formalities are always a major issue and creditors must be aware of tactics delaying the publications that may lead to material postponements and ambiguities.

Effects of a declaration of insolvency

Once the initial judgment declares the debtor in a stage of insolvency or concurso mercantil, attachment or foreclosure of assets is suspended during the conciliatory stage, with the sole exception of labour-related obligations. Tax-related attachments or liquidations under specific provisions of the Concurso Law are specifically stayed.

The debtor maintains the administration during the conciliatory stage, although the conciliator may request the court removal of the administration. With the express purpose of conserving the enterprise as a going concern within the conciliatory stage, the conciliator is given broad powers to decide on the acceptance or rejection of contracts (within certain parameters), the contracting of new loans – although most litigators insist that the judge must approve – and the sale of non-essential assets. In all cases, the conciliator must constantly report to the court every 72 hours – which is obviously burdensome in major filings – of each and every payment to any supplier or person.
Debts in foreign currency

The Concurso Law attempts to correct prior judicial practice, which converted foreign currency debt to pesos early on in the proceeding. The Law establishes provisions that are designed to protect the monetary value of creditor loans. All peso-denominated obligations are converted into inflation-linked units known as UDIs; foreign currency-denominated obligations are converted into pesos at the prevailing rate of exchange on the date the insolvency judgment is rendered and then converted into UDIs. Only claims with a perfected security interest (mortgages or pledges – but not in regard to guarantee trusts) will be maintained in their original currency or unit of account, and will continue to accrue interest, but only to the extent of the value of the collateral.

Fraudulent conveyances

The Concurso Law provides for a general rule as to the period when insolvency is presumed to have begun, which is of 270 calendar days prior to the judgment declaring insolvency (the ‘retroactive period’). Nevertheless, upon the reasoned request of the conciliator, the interventors, who may be appointed by the creditors to oversee the process, or any creditor, the judge may determine a longer period (at most, three years). Conveyances that are not arm’s-length or commercially sound, and the creation or increase of security interests within the retroactive period will be presumed fraudulent to creditors and will not be recognised.

Netting

The general concept of netting is recognised by the Concurso Law, which specifies that netting is mandatory for parties to a transaction recognised by the Law, pursuant to terms agreed upon in the relevant contract, on the date of the declaration of insolvency, in respect of liabilities and rights arising from master or specific agreements entered into in connection with financial derivative transactions, reportos (Mexican law-governed repurchase transactions), securities lending transactions and other equivalent transactions.

Mandatory netting is also recognised by the Law as an exception to the ‘cherry-picking’ powers given to the conciliator (i.e., mandatory netting applies, regardless of whether the conciliator decides to assume or reject the relevant executory contract).

Under the Concurso Law, the effects of a netted transaction are deemed to survive, even if the transaction was netted during the insolvency retroactivity period (as mentioned previously, generally 270 days). This provision constitutes another development that has given financial institutions certainty when netting, on a bona fide basis, financial derivative transactions.

Obviously, as a prerequisite to netting, the Concurso Law accepts the principle of early termination. It establishes that financial derivative transactions and reportos transactions, maturing after the date of the declaration of insolvency, shall be deemed terminated precisely on that date.

In connection with financial derivative transactions, the Concurso Law provides that, if the relevant agreement does not specify the terms pursuant to which a transaction is to be closed-out and netted, the value of the underlying assets and liabilities is to be determined on the basis of their market value on the date of the declaration of insolvency; if such market value is not available or cannot be demonstrated, the conciliator may request an experienced third party to determine such value.

The general concept of netting reflected in the Concurso Law should be broad enough to encompass transactions such as New York or English law-governed repurchase transactions.
transactions, securities loan agreements and any other transactions that may be expressed in other currencies. However, the broad terms of the relevant provisions in the Concurso Law, may result in abuses that would seem to go beyond the intent of the drafters of the Law (i.e., creditors claiming that transactions that are not financial derivative transactions, and, therefore, not benefiting from netting provisions, be considered as derivatives, by virtue of the manner through which such transactions were documented). It is also expected that complex derivatives will be challenged as invalid, based on arguments of ultra vires, lack of authority, disproportional elements and the like, specifically in times of unforeseen volatility. While such issues have been addressed by US courts (principally in New York) in favour of creditor banks in matters where Mexican companies were plaintiffs, the subject of complex derivatives is far from settled in Mexico.

xii Restructuring plan; pre-packaged insolvency

To become effective, a restructuring plan must be subscribed to by the debtor and recognised creditors representing more than 50 per cent of the sum of the total recognised amount corresponding to unsecured creditors and the total recognised amount corresponding to secured or privileged creditors subscribing the plan. For acceptance, the favourable vote of 75 per cent of third-party unsecured claims if unsecured inter-company claims account for more than 25 per cent of unsecured claims must be obtained. Any such plan, with the validation of the court, would become binding on all creditors and the insolvency proceeding will be considered as final and concluded.

One significant problem with the statute is that there are no provisions allowing qualified majorities to impose a plan on any recalcitrant participant in regard to secured creditors, although there are different largely untested theories as to how such imposition may be accomplished.

xiii Key procedural events

The key procedural events, in summary – and in theory – are as follows (approximate terms for their completion are in parentheses).

Conciliatory stage

- a filing;
- b acceptance of filing (by day 10);
- c appointment of an examiner (by day 21);
- d judgment declaring insolvency (by day 80);
- e appointment of conciliator (by day 85);
- f judgment recognising creditors and establishing preferences (by day 145); and
- g restructuring agreement (by day 365); if not, bankruptcy is declared (on day 365, at the latest).

Bankruptcy stage

The bankruptcy or liquidation stage may begin earlier, if requested at any time by the debtor or if the conciliator determines that it will be impossible to reach agreement in respect of a restructuring agreement. Creditors may demand that the concurso begin at the bankruptcy stage, but it is extremely unlikely any such demand will actually prevail. Once the bankruptcy stage is declared, a receiver is appointed, which may be the same person who acted as
conciliator (by day five of the declaration); the receiver takes over possession of the enterprise and its management (by day 20); the receiver prepares and delivers liquidation balance sheets and inventories (by day 75); the individual assets or the enterprise as a whole are slated for the sale and notices are sent out to potential bidders (by day 135); asset sales begin (the general rule is to conclude liquidation by day 180); and payment to recognised creditors, subject to the preference of labour and, thereafter, secured creditors and taxing authorities, will begin as soon as practicable. In practice, very few cases have reached this stage, and save for only one case, they have all failed to adhere to the time frames set forth by the Law, missing the mark by many years.

xiv Other provisions

The 2014 amendments overhauled the whole bank resolution regime, and expunged it from the Concurso Law so that it is governed solely by the Credit Institutions Law. It also includes a chapter that refers to international cooperation in insolvency proceedings (in a similar fashion as Chapter 15 in the US but with substantial changes that make it inoperative). Finally, it also refers to conducts and liabilities that will be considered criminal in nature, and refers to specific prison terms that may be applied to administrators and directors committing criminal conduct.

xv Duties of directors

The Concurso Law includes a regime for director liability for all business entities, which could have an impact on the manner in which directors behave in the imminence of insolvency and the way in which these issues are addressed by the courts.

Disinterested directors are protected from liability under ‘business judgement’ provisions, based on the presumption that directors have acted on an informed, good faith basis, on the belief that the action taken was an adequate alternative, if based upon reliance on management and the advice of the corporation’s external auditors or legal and financial advisers.

It is the view of the author that as a legal matter, directors and officers must manage an insolvent company and maximise its value for the benefit of all of its stakeholders. The focus should be maximising the value of the enterprise, rather than attempting to maximise recoveries for any particular constituency.

III RECENT LEGAL DEVELOPMENTS

The latest amendments to the Concurso Law were enacted by Congress in 2014. The principal objectives of the reform focused on the goals of a more expedient and efficient procedure, greater transparency and a reasoned intent to formally introduce DIP financing – certainly bold intentions.

The most relevant provisions introduced by Congress were:

- prohibiting the judge from extending the periods set forth in the Concurso Law;
- the consolidation of *concurso mercantil* proceedings of companies that are part of the same corporate group, the concept of which now includes companies that have the capability to make decisions with respect to another company, regardless of the actual shareholdings;
- the ability of a debtor to request the *concurso mercantil* status prior to being generally in default with respect to its payment obligations, when such situation is expected to occur inevitably within the following 90 days;
the possibility of requesting a concurso mercantil directly in the stage of bankruptcy (liquidation); 
permitting common representatives to file credit recognition claims on behalf of a group of creditors and the addition of certain rules for the subscription of the debt restructuring agreement in the case of collective credits through their individualisation; allowing for the use of standardised forms to voluntary request or involuntary demand concurso mercantil; the prospect of filing petitions and other communications electronically; an emphasis on transparency; provisions permitting debtors to obtain DIP financing as necessary to maintain the ongoing business of the company and the essential liquidity during the concurso, the financing of which will be considered privileged in ranking (with a preference over all secured creditors) for purposes of the preference of the payment thereof in the event of a liquidation; the recognition of subordinated creditors, including inter-company creditors in accordance with certain rules, which, among others, establish that such inter-company creditors will not be allowed to vote for the approval of the debt restructuring agreement when such inter-company creditors represent 25 per cent or more of the total amount of recognised credits, unless such creditors consent to the agreement adopted by the rest of the recognised creditors of the same class; and the broadening of the retroactivity period applicable for the review of fraudulent conveyances with respect to transactions entered into with inter-company or related creditors.

With respect to the concurso mercantil proceeding with pre-packaged plan, the Concurso Law permits the appointment of a conciliator who is not registered with the IFECOM by the agreement of the debtor and creditors representing at least the majority of the total amount of debt. Likewise, the percentage required for filing a petition for concurso mercantil with a pre-pack plan was increased to provide that creditors representing at least a majority of the total amount of the abilities of the company must subscribe to the pre-pack plan.

To avoid abuses in respect of an insolvent debtor, the amendments to the Concurso Law also included a new set of provisions that refer to the potential liability of the debtor’s management and relevant employees for damage caused to the debtor company if: acting with a conflict of interest; favouring one or more shareholders and causing damage to other shareholders; obtaining economic benefits for themselves or for others; knowingly making, providing, disseminating, publishing or ordering false information; ordering or causing the accounting registries, related documentation or conditions in a contract to be altered, modified or destroyed; failing to register transactions or causing false information to be registered, or causing non-existent transactions or expenses to be registered, or real transactions or expenses are exaggerated, or otherwise carrying out any act or transaction that is illegal or prohibited by law, causing a damage to the bankrupt debtor and obtaining an economic benefit, directly or indirectly; and in general carrying out any wilful or illegal act or acting with bad faith pursuant to the Concurso Law or other laws.
Although the Concurso Law adopted the business judgment rule contained in the Securities Law applicable to the members of the board of publicly traded companies and allows such directors and relevant employees to obtain insurance, guaranty or bonds to cover the amount of the indemnification for losses and damages caused, except for wilful misconduct, acts of bad faith, the Concurso Law expressly prohibits any agreement, or provisions in the by-laws with respect to any type of consideration, benefit or exemption that may limit, release, substitute or redeem the liabilities of such members of the board and relevant employees of a bankrupt debtor in the event of wilful misconduct or bad faith.

IV  SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

Recent cases have continued to underline material limitations in regard to concurso proceedings, the Empresas ICA matter being the exception.

Although the Law allows creditors and debtor companies in a pre-pack concurso to appoint a conciliator who is not a member of IFECOM, understandably IFECOM has been a zealous protector of its oversight responsibility, placing a stringent scrutiny on any such conciliator – and perhaps, acts of harassment – especially with respect to formalities that seem to go well beyond the Law. There continues to be a marked emphasis on the use of cumbersome IFECOM formats and computer programs, which are not designed for large corporations, causing many delays at all stages of the procedure. The procedure and requirements that have been imposed by IFECOM in regard to the recognition of creditors stress the physical delivery of original documents, which in practice has meant that the conciliator may not rely on the audited financial statements of the company but on empirical evidence of debt, which may lead to months of otherwise inexplicable interruption, notwithstanding that the Law provides otherwise. The author continues to strongly disagree with such policies and impositions. In addition, in regard to individual bondholder recognitions, the compulsory IFECOM formats have referred to ‘assignment of credits’ where in legal terms there are none, as the applicable concept is the individualisation of a collective claim – the bond issue – and not an assignment.

Substantial formalities imposed on the judicial procedure have led to little transparency. The Federal Judiciary has failed to implement electronic filings of any sort, which leads to a considerable administrative burden on the courts themselves, not to mention a colossal waste of paper and natural resources. As a consequence, reviewing all the documents actually filed in any major process is a task of gargantuan proportions, which of course affects the timing of the concurso – the ‘strict’ time periods in the Law have been extended more often than not – and moreover, create a perfect setting for many appalling delaying tactics, which do not merit a serious comment, although their existence is undeniable.

As to DIP financing, Mexican companies have not been aided by debtor-in-possession financing from Mexican banks or institutional sources, and foreign entities have failed to be persuaded to fund any such facilities until now, given continuing procedural uncertainties resulting in questions as to preference. In any event, the demands by lenders once a concurso is in process for security over and above the statutory priority have severely limited DIP financing. Notwithstanding this, in exceptional circumstances DIP financing has been provided successfully and without challenge.

As to the ranking of claims, only registered mortgages and pledges have been given statutory preference on a clearly reliable basis, given a literal reading of the Concurso Law.
Creditors holding security rights under trusts or escrows have been recognised in most cases as common creditors only, although they are given the ‘privilege’ of separating assets in trust from those of the company in question, a concept that makes little sense in view of the stated objective of the Law: to keep the corporation as an ongoing concern during the workout or conciliatory stage of the *concurso*. Breaking up operating assets is inconsistent with this objective. A better view is that such creditors should be recognised as creditors with a stated contractual privilege to specific assets or flow of funds, irrespective of any procedure of separation – a view that is supported by a correct reading of the Law and by the author.

As to expenses, formal cases have brought about a debate both at IFECOM and among a number of judges, as to which concepts will actually be recognised as reimbursable expenses in a *concurso* proceeding. Professional fees, legal and those of financial advisers, have often been considered as substantially onerous and have thus been reduced significantly. In the extreme, the professional fees of a conciliator in a major case, were turned down by the judge as unnecessary.

Among the more alarming points of view generally shared by the litigation bar, is that, to the extent a capitalisation of debt becomes part of an exit plan, even if voted upon and approved by overwhelming majorities of every class of creditor, shareholders do in fact have a veto power over a plan if they disagree. The author, even though his view is by no means widely accepted, does not share this perspective as it is contrary to the notion of absolute priority, and because the Concurso Law empowers the judge to impose the capitalisation, although most judges are and will be reluctant to do so.

V INTERNATIONAL

The Concurso Law embraces, in form, the UNCITRAL Model Law on cross-border insolvency and international judicial cooperation. Mexican courts have sporadically recognised and given limited judicial assistance to foreign insolvency proceedings (provided that such proceedings do not contradict Mexican law or general principles of law), although there have been very few such cases. The Concurso Law includes substantial changes to the UNCITRAL Model Law that make the process defective as it focuses on channelling procedures through a conciliator, and thus effectively imposes the need to file a full *concurso* proceeding in regard to any significant assets in Mexico.

Related to this topic, Mexican companies have more frequently filed for protection in the bankruptcy courts of the US (mainly in the Southern District of New York and in Delaware) under Chapter 15, after a company is declared in *concurso* in Mexico, and certainly such courts have responded efficiently, recognising the *concurso* as the main proceeding. Unless the conciliator implements an indirect channel of communication between the Mexican judge presiding over the main proceeding and courts outside Mexico, cross-border communication is practically non-existent.

VI FUTURE DEVELOPMENTS

*Concurso mercantil* as a formal insolvency procedure under Mexican law has fallen into greater ambiguity in recent years and its reliability is highly questionable. There have been decisions by the Mexican federal judiciary that have undoubtedly contributed to this. Courts have resolved, for example: (1) trust structures (*fideicomisos*) related to the capture of monetary flows from contracts entered into by a debtor and used as a source of repayment in structured
finance transactions, will not be honoured upon a declaration of *concurso*, despite a ‘true sale’ (but will be channelled to the bankruptcy state); (2) the conciliator is to be the sole representative of the interests of creditors in regard to any post-*concurso* appeal, even though the conciliator is statutorily impartial; (3) no creditor can be forced to capitalise its loan under an approved plan; (4) consumers are protected by human rights and are a privileged class above secured creditors; and (5) a conciliator may be found to have a conflict of interest if, even four years after the conclusion of a *concurso mercantil*, he or she carries out a professional activity for a former creditor in the case in which a plan was approved. While these baffling precedents are not yet mandatory, they are highly disconcerting.

The IFECOM is now headed by a lawyer who does not come from the judiciary, a fact many practitioners see as a positive development. The IFECOM must become more involved in a positive, transparent and efficient way in *concursos mercantiles*. The expectations are high.

It would be reassuring to return to the rule of law through a more effective insolvency regime aimed at ensuring the reasonable protection of debtors and creditors, and in general, of all stakeholders in economic enterprises, which will lead to prosperity and progress.
I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

i Liquidity and state of the financial markets
Quantitative easing by the European Central Bank and others has resulted in high liquidity levels and low funding costs for Dutch borrowers. Dutch corporates have also had good access to financing because foreign financiers and investors have been showing an increasing appetite for Dutch assets. Notably, in the sub-investment grade market, unitranche lenders are gaining market share in mid-market situations that were traditionally dominated by the Dutch banks (often teaming up in club deals). In the bigger ticket market, borrowers have also had very good access to ‘covenant lite’ financings provided by institutional investors (as high-yield bonds or as a bank-style leveraged loan). There was so much liquidity in that sector of the market in 2018 that borrowers managed to further erode customary credit protections. As far as acquisition financing is concerned, 2018 saw private equity buyouts returning to pre-2008 levels for the first time. The market saw some major divestments by large corporates, with private equity coming out very strongly (e.g., Unilever divesting its spreads business to KKR, Akzo Nobel divesting Nouryon to Carlyle). Leaving aside an overall market dip at the end of the year, the buy-out financings were generally well received in the institutional markets and were often also leveraged further by second lien or senior subordinated financings.

ii Impact of specific regional or global events
Uncertainties around the UK–EU relationship after Brexit, the UK market after Brexit and a global trade war unleashed by Donald Trump affected the markets in 2018. While there was continued M&A activity, many names expected to come to market eventually did not come or were pulled because they were perceived to have too much exposure to these uncertainties. In addition to transactions with a more domestic focus, sectors for which the markets remained buoyant included real estate, infrastructure and services.

In the retail sector, fierce competition between low-budget competitors, online platforms and other market disruptors continue to drive changes. The sector has seen the successful players become the subject of very significant M&A scenarios, while the players unable to adapt to new market circumstances often ended up in insolvency, albeit mostly emerging with a significantly reduced number of stores.
Market trends in restructuring procedures and techniques employed during 2018

Pre-packaged insolvencies (pre-packs) remain an area of focus in the Netherlands. In order to ensure continuity of a stressed business, a debtor, sponsor, their advisers and key creditors (notably secured lenders and key suppliers) prepare a deal, following which the court appoints a liquidator to assess the proposed restructuring as a transaction that might be implemented on the first day of an actual bankruptcy. While the Dutch legislator continues to work on a broader statutory platform for pre-packs (see Section VI.ii), employee rights have taken centre stage in the discussion. Following the recent judgment of the European Court of Justice (ECJ) concerning the Estro pre-pack, pre-packs can in most instances no longer be used as a tool to make part of the workforce redundant, at least not without making severance payments. As mentioned in the previous edition of this volume, it follows from recent case law of the Supreme Court that no prior approval of the works council is required for the liquidator to decide on asset disposals or the dismissal of employees. However, such decisions by the liquidator do require prior approval in case of a going concern sale pursuant to which (a part of) the debtor's business is continued or if business rescue is facilitated within the same corporate entity (e.g., by the adoption of a composition plan).

In retail insolvencies, one enforcement method that is regularly used includes a liquidation sale conducted by the liquidator under a mandate granted by the secured creditor. Any cash and electronic payments made by customers in respect of encumbered property are deemed to constitute enforcement proceeds available for distribution to the secured creditor. In recent insolvencies in the retail sector, it appears that landlords increasingly capitalise on hold out value. The termination of a lease in respect of premises on favourable locations could easily thwart any corporate rescue attempt of the debtor’s ailing business. Nevertheless, in most cases where a going concern sale is viable, the landlord will cooperate in facilitating the sale by accepting the purchaser of the debtor’s business as a new lessee.

In larger insolvency proceedings containing numerous (notably financial) creditors, debt restructurings generally take place through a consensual deal or a restructuring plan combined with a statutory cramdown mechanism in formal proceedings or by using a foreign route (e.g., a scheme of arrangement under English law).

Number of formal procedures entered into or exited during 2018

According to details made available by the Central Bureau of Statistics of the Netherlands (CBS), the total number of corporate bankruptcy proceedings commenced in 2018 amounts to 3,144 new cases (excluding sole proprietors and traders). This represents a decrease of approximately 4.5 per cent compared to the number of new filings in 2017, and is the lowest number since 2000. The decrease in the number of new bankruptcy cases is linked

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2 The Minister of Justice and Security wrote in a letter to Parliament that case law will ultimately provide more clarity on the consequences of the judgment of the ECJ in the Estro case. Thus far, there are a few judgments where lower courts had to rule whether or not the case was similar to the Estro pre-pack. See Court of Appeal Arnhem-Leeuwarden 17 July 2018, JOR 2018/265; Court of Appeal Amsterdam 10 July 2018, JOR 2018/264; District Court Gelderland 1 February 2018, JOR 2018/111; Cantonal Court Limburg 26 September 2018, JOR 2018/316.

3 Such prior approval is governed by Article 25 of the Works Council Act.

4 Article 176 of the Bankruptcy Code.

5 Such dismissal may occur pursuant to Article 40 of the Bankruptcy Code. Cf. Supreme Court 2 June 2017, JOR 2017/248 (DA).
to the recovery of the Dutch economy in recent years. However, the decrease in percentage is substantially lower than in previous years. For example, in 2017 there was a decrease of approximately 25 per cent compared to the number of new filings in 2016.

Similar to previous years, most new bankruptcies have been recorded in the wholesale and retail sector. A total number of 320 new cases were opened in the wholesale sector and 304 new cases in the retail sector. The sharpest drop (measured in percentages) in new bankruptcy cases concerned the real estate leases and trading sector (a decrease of 48 per cent).6

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Available insolvency and restructuring procedures7

The Bankruptcy Code provides for three main formal proceedings: bankruptcy, suspension of payments and debt adjustment for natural persons.

Bankruptcy proceedings have been primarily designed as liquidation proceedings, but in practice, can function as a restructuring tool (e.g., through a composition plan or by means of a going-concern sale of the debtor’s viable business parts). The primary objective of suspension of payments proceedings is the reorganisation and continuation of the debtor’s business, but the limited scope of the proceedings – confined to ordinary (i.e., unsecured and non-preferential) insolvency claims – and continued application of transfer of undertaking protection rules render it ineffective for many restructurings.8 The main purpose of debt adjustment for natural persons is to provide heavily indebted natural persons with a fresh start. Considering the focus of this chapter on large corporate debtors, debt adjustment for natural persons will not be further dealt with.

The Bank Recovery and Resolution Directive (BRRD)9 and the Single Resolution Mechanism Regulation (the SRM Regulation)10 provide for a European approach towards the recovery and resolution of banks and large investment firms (and certain affiliated entities) in distress. To facilitate a timely intervention in respect of such institutions, national legislation implementing the BRRD and the SRM Regulation grants certain intervention powers to

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8 Article 232 of the Bankruptcy Code, Article 7:663 and Article 7:666 of the Civil Code. Following the aforementioned decision of the ECJ concerning the Estro pre-pack, such rules may also apply in case of a going concern sale implemented in bankruptcy proceedings (prepared as a pre-pack).
competent resolution authorities. Beyond the scope of the BRRD and the SRM Regulation, the Dutch Central Bank has powers to procure that a bank in serious financial problems is transferred, in whole or in part, to a third party. Furthermore, the Dutch Minister of Finance holds powers to intervene in the affairs of banks, investment firms and (managers and custodians of) investment institutions (all as defined in the Financial Supervision Act), including the power to expropriate their shares or capital instruments and some or all of their assets (e.g., as applied to the nationalisation of SNS REAAL NV and SNS Bank NV in February 2013), where this is necessary to safeguard the stability of the Dutch financial system.

Restructurings often occur beyond the setting of formal insolvency proceedings (e.g., through security enforcement, new or amended financing arrangements, contractual restructuring arrangements or foreign restructuring routes). The main disadvantages of such informal restructurings often include the lack of a stay on individual recourse rights of creditors and the absence of a cramdown mechanism in relation to dissenting and non-participating creditors, beyond those mechanisms agreed between creditors. Changes to the statutory framework are pending to enhance attempts to restructure financially distressed companies outside formal insolvency proceedings (see further in Section VI.ii).

**ii The taking and enforcement of security**

Loans granted to a corporate debtor can be secured over the company’s assets. Creation requirements of security rights are governed by general rules of property law and depend on the relevant type of collateral. All-embracing security can be obtained by a combination of pledges and mortgages over assets comprising the debtor’s business.

An important effect of the commencement of bankruptcy proceedings is the divestment of the debtor (i.e., the debtor loses the power to dispose of and administer the assets included in the insolvent estate).\(^\text{11}\) Pledges granted in advance over future property\(^\text{12}\) can no longer crystallise after the debtor’s divestment.\(^\text{13}\) During the course of bankruptcy proceedings, the liquidator is exclusively entitled to dispose of and administer the insolvent estate.\(^\text{14}\)

The secured creditor in Dutch insolvency proceedings can enforce its rights as if the proceedings had not been opened.\(^\text{15}\) Enforcement of security can only be temporarily stayed by the order of a moratorium at the time of the bankruptcy adjudication or subsequently by the supervisory judge.\(^\text{16}\) Such a moratorium can last for a maximum period of four months (including extensions). The liquidator has powers to expedite enforcement of security by demanding that the secured creditor realise the collateral within a reasonable time period.\(^\text{17}\) Failure to enforce within that time period will result in a loss of enforcement rights and an

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11 Article 23 of the Bankruptcy Code.
12 Mortgages cannot be granted in advance over future immovable assets, registered ships and registered aircraft. See Articles 3:97(1) and 3:98 of the Civil Code.
13 Articles 23 and 35(2) of the Bankruptcy Code.
14 Article 68(1) of the Bankruptcy Code.
15 Article 57(1) of the Bankruptcy Code.
16 Article 63a of the Bankruptcy Code.
17 Article 58(1) of the Bankruptcy Code.
obligation to share in the general realisation costs of the proceedings.\(^{18}\) A final limitation on the position of the secured creditor is that it cannot enforce its security in respect of all claims that might arise after the opening of insolvency proceedings.\(^{19}\)

In practice, the secured creditor and the liquidator often agree on the realisation of the secured asset by the latter against the deduction of a nominal fee from the realisation proceeds.

### iii  Duties of directors of companies in financial difficulties

No statutory obligation exists for directors of a financially distressed company to file for insolvency proceedings. Nevertheless, governance of the company may be placed under increased scrutiny by third parties and continued trading may give rise to director’s liability.

In essence, directors would face liability if their behaviour was negligent towards a third party and constituted serious personal wrongdoing.\(^{20}\) A prominent ground for personal liability is when directors allowed the debtor to execute a transaction with a third party while they knew (or should have known) that the debtor would be unable to meet its obligations under that transaction and that the deprived counterparty would not have sufficient recourse for its damages.\(^{21}\) Director’s liability can also arise from actions that resulted in default and non-recoverability of damages,\(^{22}\) as well as selective payments (e.g., non-payment to a particular creditor based solely on unwillingness of the director to allow such payment to be made).\(^{23}\)

Each director can also be held personally liable for the entire deficit of the bankrupt estate if their improper management caused the bankruptcy.\(^{24}\) By statute, improper management is established if books and records of the bankrupt company have not been properly maintained or if directors failed to meet obligations regarding the company’s annual accounts. Subject to proof to the contrary, that improper management is also assumed to have caused the bankruptcy.\(^{25}\)

Directors can also be held liable by the company for improper performance of management tasks allocated to them by law or the articles of association.\(^{26}\) Examples of

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18 Articles 58(1) and 182 of the Bankruptcy Code.
19 It follows from Article 132(2) of the Bankruptcy Code and Article 483e of the Civil Procedure Code that security can only be enforced during insolvency proceedings for (1) pre-commencement secured claims; and (2) post-commencement secured claims which originate from a pre-commencement legal relationship. Cf. also Supreme Court 16 October 2015, JOR 2016/20; NJ 2016, 48 (DDL/Van Logtestijn).
20 Article 6:162 of the Civil Code.
21 Supreme Court 6 October 1989, NJ 1990, 286 (Reklamell).
23 Cf. e.g. Supreme Court 26 March 2010, JOR 2010/127; NJ 2010, 189 (Zandvliet/ING).
24 Article 2:138(1) and Article 2:248(1) of the Civil Code regarding public and private limited companies. Such improper management must have occurred within three years of the commencement of the bankruptcy proceedings. See Article 2:138(6) and Article 2:248(6) of the Bankruptcy Code. The scope of the provision is extended to shadow directors pursuant to Article 2:138(7) and Article 2:248(7) of the Civil Code.
25 Article 2:10 of the Civil Code.
26 Article 2:9(1) of the Civil Code.
circumstances in which directors can be held liable include violation of the law or articles of association, procuring reckless and irresponsible financial behaviour of the company and utilising assets of the company for personal benefit.27

iv Clawback actions

During bankruptcy proceedings, a liquidator may invoke the *actio Pauliana* in order to invalidate antecedent transactions that are detrimental to the insolvent estate. Clawback generally requires prejudice, which will materialise in the event creditors receive a lower distribution on their claims as a result of a transaction.

Prejudice would typically be the result of a reduction in the total value of the debtor’s estate as a result of a transaction (transactions at an undervalue) or as a result of a disturbance of the statutory waterfall of priorities when a company is already insolvent (preferences). The liquidator should look at the entire transaction (including beneficial aspects of the transaction) and, therefore, has no right to cherry-pick by only looking at one particular provision of a document as a clause that has a negative impact on the recourse position of the joint creditors. If the disputed act was part of a set of transactions, the positive or negative effects of the combined set should be regarded as well.28

Where prejudice has been established, the right to challenge the prejudicial action depends on further circumstances. The avoidance of an act entered into without a pre-existing obligation to perform the relevant act requires that the debtor (and in the case of a transaction against consideration, also the counterparty) knew or should reasonably have known that such prejudice would materialise.29

Knowledge of a mere chance that prejudice may occur is insufficient to invoke the *actio Pauliana*. Knowledge must relate to a reasonable degree of likeliness that insolvency proceedings will be opened and that the insolvent estate contains a deficit.30 In certain cases, the onus of proof regarding knowledge of prejudice is reversed by law (e.g., in the event of certain transactions executed between related parties within a period of one year prior to the bankruptcy date).31

A compulsory or involuntary legal act, on the other hand, can only be avoided either in the event that the transaction occurred at a time in which the counterparty knew or ought to

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27 Other circumstances that may be relevant include the nature of the company’s activities and corresponding risks, the allocation of tasks within the board of directors, possible guidelines applicable to management, the information available to directors at the time of scrutinised actions and decisions, and the knowledge and prudence which may generally be expected of a director which is sufficiently prepared and performs his task in a diligent manner. See Supreme Court 10 January 1997, JOR 1997/29; NJ 1997, 360 (Staleman/Van de Ven).
29 Article 42 of the Bankruptcy Code.
31 Article 43 of the Bankruptcy Code.
have known that a petition was submitted for the commencement of insolvency proceedings against the debtor,\textsuperscript{32} or in the event of a concerted action by the debtor and the creditor aimed at facilitating preferential treatment of the latter (collusion).\textsuperscript{33}

Finally, it should be noted that set-off effected in the period immediately prior to the commencement of insolvency proceedings could be clawed back if the creditor effecting the set-off acted in bad faith when acquiring its claim or debt on which it relied when setting off.\textsuperscript{34} Bad faith is, notably, given when the creditor knew or should have known that the insolvency could reasonably be expected.\textsuperscript{35} A similar rule applies to the right of an account bank to exercise its pledge over monies standing to the credit of bank accounts of its clients (such a pledge is generally stipulated in the general terms and conditions used by the relevant account bank). The pledge cannot be exercised by account banks in relation to monies paid into the account at a time when the account bank is considered to be in bad faith (as defined above).\textsuperscript{36}

\section*{III \hspace{1em} RECENT LEGAL DEVELOPMENTS}

\textbf{i} \hspace{1em} Court order sanctioning private enforcement of a share pledge

The basic assumption under Dutch law is that the enforcement of a right of pledge occurs through a public sale.\textsuperscript{37} A private sale or appropriation of pledged assets by the pledgee is permitted (1) if prior leave is obtained from the court;\textsuperscript{38} or (2) if such enforcement is agreed upon between the pledgor and the pledgee at a time on which the debtor is in default in the repayment of the secured obligations (any earlier consent provided by the pledgor (in advance) is considered to be null and void).\textsuperscript{39} Share pledges are generally enforced by means of a private sale (e.g., following a ‘closed auction’ process).

In a recent case before the Supreme Court, the interplay was addressed between the aforementioned enforcement rules and limitations imposed by the articles of association on (among other things) the enforcement of share pledges (e.g., pre-emption rights). The view was confirmed by the Supreme Court that any transfer limitation rules provided for in the articles of association must be adhered to by an enforcing pledgee (as follows explicitly from a statutory provision),\textsuperscript{40} but that the relevant company regime does not displace the statutory rules on enforcement of share pledges.\textsuperscript{41} Hence, the application of pre-emption rights cannot displace the requirement of court leave or consent by the pledgor (as described above) for the private enforcement of the share pledge to take place.

\begin{footnotesize}
\begin{itemize}
\item Knowledge of the mere likelihood that insolvency proceedings may be opened is insufficient to meet this requirement. See Supreme Court 16 June 2000, NJ 2000, 578 (Van Dooren qq/ABN AMRO Bank f).
\item Supreme Court 24 March 1995, NJ 1995, 628 (Gispen qq/IFN) and Supreme Court 20 November 1998, JOR 1999/19; NJ 1999, 611 (Verkerk/Tiehoff qq).
\item Article 54(1) of the Bankruptcy Code.
\item Supreme Court 7 October 1988, NJ 1989, 449 (AMRO/THB).
\item Cf. Supreme Court 23 November 2018, JOR 2019/27 (Eurocommerce).
\item Article 3:250 of the Civil Code.
\item Article 3:251(1) of the Civil Code.
\item Article 3:251(2) of the Civil Code.
\item Article 2:198(6) of the Civil Code provides that rules included in the articles of association concerning a transfer of shares apply \textit{mutatis mutandis} to share pledge enforcements or appropriation of shares by the pledgee pursuant to Article 3:251 of the Civil Code.
\item Supreme Court 22 June 2018, JOR 2018/310; NJ 2018, 429 (Bethanie/Rabobank cs).
\end{itemize}
\end{footnotesize}
ii Enforcement of a pledge over bank accounts in respect of pre-commencement payment orders

It is explicitly precluded by law to invoke a right of set-off during insolvency proceedings in respect of claims or liabilities which were acquired by the debtor’s counterparty at a time when the debtor’s insolvency could reasonably be expected.\(^{42}\) In previous judgments of the Supreme Court it was held that a similar rule can be deemed to apply in respect of the enforcement of security rights for secured liabilities which were transferred to the secured creditor by a third party at a similar point in time (as described above in relation to insolvency set-off).\(^{43}\) The last piece of the puzzle to equate the rules applicable to insolvency set-off and the enforcement of security rights during insolvency proceedings was whether the same rule can be deemed to apply in relation to the enforcement of a pledge over bank accounts granted to account banks in respect of monies paid onto the account pursuant to payment orders made at a time on which the debtor’s insolvency could reasonably be expected. As a result of the payment transfer to the account holder (pledgor), the account bank becomes indebted to the account holder. If the timing of such payment transfer would render insolvency set-off prohibited, this rule cannot be evaded by enabling the account bank to enforce its right of pledge over the relevant bank account.\(^{44}\)

An exception to the above rules applies in respect of set-off during insolvency proceedings by an account bank that has been granted a right of pledge on receivables that are paid by means of a payment transfer to the account holder.\(^{45}\)

iii Creditor remedies against a (going concern) sale contemplated by the liquidator

Certain stakeholders (including insolvency creditors) can request the supervisory judge to issue an instruction to the liquidator to perform a certain act or to refrain from doing so.\(^{46}\) For example, a creditor can request the supervisory judge to prohibit a public or private sale of assets as contemplated by the liquidator. The request lodged by the creditor can also relate to the terms of a specific sale agreement or the identity of the third party purchaser (e.g., a party related to the insolvent debtor).\(^{47}\) The supervisory judge will balance the legitimate interests of the petitioning party and the general interest of the debtor and the joint creditors in an expedient settlement of the insolvency proceedings. In principle, the decision of the supervisory judge can be appealed (unless the relevant decision concerns approval granted to the liquidator to execute a private sale of assets belonging to the insolvent estate).\(^{48}\)

iv Status of post-commencement claims originating from pre-commencement legal relationships

In a landmark decision of the Supreme Court\(^{49}\), the view was held that post-commencement claims that arise from pre-commencement legal relationships (i.e., contractual relationships

\(^{42}\) Article 54(1) of the Bankruptcy Code.

\(^{43}\) Cf. Supreme Court 30 January 1953, NJ 1953, 578 (Doyer & Kalff) and Supreme Court 4 November 1994, NJ 1995, 627 (NCM/Naottenbelt qq).

\(^{44}\) Cf. Supreme Court 23 November 2018, JOR 2019/27 (Eurocommerce).


\(^{46}\) Article 69(1) of the Bankruptcy Code.


\(^{48}\) Article 67(1) of the Bankruptcy Code.

\(^{49}\) Supreme Court 19 April 2013, JOR 2013/224; NJ 2013, 291 (Kooi/Tideman qq).
executed between the debtor and a counterparty prior to insolvency) are admissible in insolvency proceedings as ordinary insolvency claims. This decision significantly reduced the number of claims that had previously been treated as administration claims (i.e., claims against the estate). Various questions triggered by the ‘new approach’ of the Supreme Court were answered in subsequent case law. An important example concerns the question whether a secured creditor may enforce a right of pledge or mortgage during insolvency proceedings for secured claims which will come into existence after the commencement of the proceedings (and possibly even after the enforcement has occurred). The Supreme Court endorsed the view that the secured creditor was entitled to do so provided that such post-commencement claims originate from a pre-commencement legal relationship. A similar rule applies to insolvency set-off which can be invoked by the debtor’s counterparty in respect of any reciprocal claims which existed at the time of bankruptcy adjudication or which originate thereafter from a pre-commencement legal relationship.

In a recent case regarding the treatment of post-commencement claims as ordinary insolvency claims (as discussed above), the Supreme Court has confined the scope of such claims which are admissible in the proceedings. If post-commencement claims arise from a pre-commencement legal relationship due to acts performed by the counterparty to which the latter was entitled but not obliged under the existing (contractual) relationship, the relevant post-commencement claims of the counterparty are inadmissible. In contrast, any post-commencement claims which originate from such legal relationship due to acts performed by the counterparty prior to the commencement order or due to mandatory acts of the counterparty performed during the proceedings, are thus admissible as ordinary insolvency claims. The latter rule also applies to any statutory or contractual damages claims which arise during the proceedings due to non-performance of the latter category of post-commencement claims.

Admissible post-commencement claims must be submitted for admission in the proceedings pursuant to the same rules which apply to admissible pre-commencement claims (even if such post-commencement claims would originate only after the claims admission meeting). In a controversial decision of the Supreme Court, it has been held that any such claims which are unliquidated (i.e., the relevant (future) claims have an uncertain amount) must be admitted for a value that can be attributed to such claims at the date of the commencement order. Various alternative suggestions have been made in legal literature (including the treatment of unliquidated post-commencement claims on par with pre-commencement contingent claims).

50 Supreme Court 16 October 2015, JOR 2016/20; NJ 2016, 48 (DLL/Van Logtestijn qq). This outcome is based Article 132(2) of the Bankruptcy Code and Article 483e of the Civil Procedure Code.
51 See Supreme Court 26 March 1976, NJ 1977, 612 (Keulen and Oliemans qq/Cebeco); Supreme Court 16 October 2015, JOR 2016/20; NJ 2016, 48 (DLL/Van Logtestijn qq) and Supreme Court 13 October 2017, JOR 2018/48; NJ 2017, 454 (Liquidators Eurocommerce/Ontrvanger).
53 ibid.
54 ibid.
IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

As a summary, below is an overview of significant formal proceedings, informal restructurings and restarts commenced in or still pending in 2018–2019:

- bankruptcy proceedings:
  - Klesch Aluminium (previously: Aldel);
  - Doniger Fashion Group (previously: McGregor);
  - Witteveen Mode;
  - The Phone House; and
  - Roto Smeets;

- suspension of payments proceedings:
  - Vidrea Retail;

- informal debt restructuring proceedings:
  - Steinhoff Group; and

- restarts:
  - Intertoys;
  - Travelbird;
  - Sissy-boy;
  - Coolcat; and
  - Fred de la Bretonière.

V INTERNATIONAL

i General cross-border insolvency framework

The general legal framework pertaining to cross-border insolvency proceedings is primarily of European origin. Dutch courts recognise foreign insolvency proceedings that fall within the ambit of the Recast of the European Insolvency Regulation (Recast EIR)\(^{55}\) and the Winding-Up Directives concerning credit institutions and insurance undertakings.\(^{56}\) To date, the Netherlands has not adopted the UNCITRAL Model Law on Cross-Border Insolvency.

In the absence of binding international rules on recognition of foreign insolvency proceedings, other than the said EU law instruments, the fall-back position under Dutch law is based on case law only. Under that case law, foreign proceedings outside of the scope of EU law instruments are merely granted territorial effect in the following ways.

- Assets of a debtor that are situated in the Netherlands are excluded from the scope of a general attachment and a general stay under the lex concursus.

- Any legal effects of the commencement of insolvency proceedings applicable under the lex concursus cannot be invoked in the Netherlands to the extent that this would prevent the debtor’s creditors from taking recourse against assets situated in the Netherlands during or upon the conclusion of the proceedings.

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The application of the territoriality principle does not prevent any other legal effects from being invoked in the Netherlands. For example, a liquidator is entitled to administer and dispose of the debtor’s assets situated in the Netherlands, provided that such rights are conferred to him under the lex concursus and any attachments levied by an execution creditor prior to such acts by the liquidator are respected.57

ii  New case law on international jurisdiction to hear actions to set a transaction aside in cross-border insolvency proceedings

It has been held by the Court of Justice of the European Union that Article 3(1) of the European Insolvency Regulation58 must be interpreted as meaning that the courts of the Member State within the territory of which insolvency proceedings have been opened have jurisdiction to decide an action to set a transaction aside by virtue of insolvency that is brought against a person whose registered office is in another Member State.59 Such jurisdiction should be considered to be exclusive (and not optional). Hence, the liquidator is not at liberty to bring such an action before, for example, a court of the Member State in which the defendant has his registered office or habitual residence.

The case has only limited importance in respect of the Recast EIR (which contains an explicit rule on international jurisdiction for actions deriving directly from insolvency proceedings and closely linked with them in Article 6).

iii  Recognition of UK schemes of arrangement

Dutch companies have increasingly been using English law-governed schemes of arrangement as a means of implementing debt restructurings. The first case involving a Dutch company in which recognition issues have been considered is Re NEF Telecom Company BV.60 Another example entails the scheme offered by Magyar Telecom (a Dutch finance vehicle of a telecommunication group operating in Hungary).61 Other recent examples include Metinvest BV (a Dutch finance vehicle in an Ukrainian based iron ore and steel conglomerate), Indah Kiat International Finance Company BV (a Dutch finance vehicle related to the APP Group, which is primarily engaged in manufacturing paper pulp) and several entities belonging to the Estro Group (active in the childcare services industry) and the Van Gansewinkel Group (a leading group in the Dutch waste management industry). The prevailing view in legal literature and practice is that Dutch courts will probably recognise an English court order sanctioning a scheme of arrangement. There is guidance

57 See Supreme Court 2 June 1967, NJ 1968, 16 (Hiret/Chiotakis); Supreme Court 31 May 1996, JOR 1996/75 (Coppoolse/De Vleeschmeesters); Supreme Court 24 October 1997, JOR 1997/1146 (Gustafien qq/Mask); Supreme Court 19 December 2008, JOR 2009/94 (Yukos I) and Supreme Court 13 September 2013, JOR 2014/50 (Yukos IV).
58 Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (‘European Insolvency Regulation’).
59 Court of Justice of the European Union 14 November 2018, C-296/17; ECLI:EU:C:2018:902 (Wiener & Trachte/Tadescher), Reference is made by the Court to its earlier judgment of 12 February 2009, C-339/07, ECLI:EU:C:2009:83 (Seagon).
60 [2012] EWHC 2944 (Comm); recognition issues do not appear to have been raised in a prior case of a Dutch company proposing a scheme, Re DAP Holding NV[2005] EWHC 2092 (Ch).
61 Re Magyar Telecom [2013] 3800 (Ch).
that a scheme of arrangement is within the scope of the Brussels I bis Regulation,\(^{62}\) so that the Dutch court is generally not entitled to dispute the English court’s jurisdiction and refuse recognition of the scheme.

Should schemes of arrangement be outside the scope of the Brussels I bis Regulation, then alternative grounds for recognition have been identified, including:

\(a\) the Rome I Regulation;\(^ {63}\)

\(b\) the Convention providing for the Reciprocal Recognition and Enforcement of Judgments in Civil Matters (concluded on a bilateral basis between the Netherlands and the United Kingdom on 17 November 1967); and

\(c\) general Dutch private international law.

## VI FUTURE DEVELOPMENTS

### i EU instruments

The Dutch restructuring and insolvency regime is increasingly shaped by EU instruments. An important example concerns the EU Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures.\(^ {64}\) The Directive does not attempt to harmonise core aspects of formal insolvency procedures such as the conditions for opening insolvency proceedings, definitions of insolvency or the ranking of claims. Instead, the Directive focuses, as far as corporate debtors are concerned, on ensuring that a statutory framework is put in place in each Member State, which maximises the chances of a company with a viable business being able to restructure its debts before it is forced into liquidation. The European Parliament and Council adopted a joint text in May 2019. The Council is expected to adopt the Directive without further amendments in June 2019, after which it will be published in the Official Journal. Member States (which may or may not include the UK) will then have two years to transpose the Directive, with the exception of a few provisions that allow for a five-year transposition period.

Another example of such future EU developments concerns future EU measures to reduce non-performing loans (NPLs) and prevent their renewed build-up. The EU package of proposed new measures includes a proposal for an EU Directive on credit servicers, credit purchasers and the recovery of collateral.\(^ {65}\) The draft Directive proposes measures on credit servicers, credit purchasers and the recovery of collateral. It aims to encourage the development of secondary markets for NPLs by removing barriers to credit servicing and the transfer of bank loans to third parties across the EU. However, the application of many of these proposals is not restricted only to NPLs nor to portfolio trades, and accordingly

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they have the potential to impact the wider loan markets more generally. The draft Directive also provides a new framework for secured creditors to recover value efficiently through extrajudicial collateral enforcement for newly originated loans (‘accelerated extrajudicial collateral enforcement’). The new extrajudicial procedure would be accessible only when agreed in advance by both lender and borrower in the loan agreement. It is intended that most of the proposals in the draft Directive would require implementation by Member States by January 2021, with the remainder in force by July 2021.

ii Future reform of Dutch law

It is currently clear that no full revision of the statutory regime will occur in the foreseeable future. Various proposals are currently pending or have recently been implemented to improve specific parts of the current regime. Main themes of reform include:

a combating insolvency fraud through the introduction of director disqualification rules, revision of criminal law aspects of insolvency proceedings and other powers;

b the promotion of corporate rescue through the Business Continuity Acts described below; and

c the modernisation of insolvency proceedings by enhancing electronic communication modes, abolishing physical claims admission meetings, adding flexibility in the composition of the creditors’ committee and other tools.

Specific attention should be drawn to the proposed Business Continuity Act I and the Act on Court Sanctioning of a Private Restructuring Plan (the Private Restructuring Plan Act) as a precaution against bankruptcy. These Acts purport to promote the rescue of financially distressed companies at an early stage.

A proposed amendment of the current regime under the Business Continuity Act I includes the debtor's right to request the court to appoint a silent administrator (and a supervisory judge) prior to the commencement of formal proceedings. The silent administrator will, in principle, be appointed as liquidator in subsequent bankruptcy proceedings. The silent administrator can prepare the future commencement of such proceedings (including a possible going concern sale to be executed swiftly upon the commencement of the proceedings). These preparations beyond the ambit of formal (public) proceedings can have a beneficial impact on, for example, the expected sale proceeds and the preservation of employment opportunities.

The Private Restructuring Plan Act as a precaution against bankruptcy purports to introduce a statutory regime governing restructuring plans outside formal insolvency proceedings. The proposed regime provides for a cramdown in relation to creditors and shareholders dissenting to a debt restructuring supported by a majority of creditors and shareholders in the relevant class of creditors or shareholders. Sanctioning by the court of the arrangement will be binding on all creditors and shareholders involved in the settlement. A restructuring plan can be offered to individual classes. The Council of State has given its advice on the legislative proposal on 27 March 2019. The bill is now scheduled to be debated in Parliament.
Chapter 17

RUSSIA

Alexander Vaneev and Ilya Sorokin

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

i Liquidity and state of the financial markets

The Russian financial market is in a similar condition to markets in other emerging economies. Its main features are the prevalence of banks over non-credit financial institutions, high-interest rates (as well as the absence of negative interest rates) and a lower-than-average level of payment discipline of debtors. Other features include a fairly high level of concentration in certain sectors, primarily in the banking sector where two to three state-owned banks, around two private banking groups and approximately three subsidiaries of certain major US/EU banks effectively dominate the market.

Weak development of the Russian capital market and the lack of permanent institutional investors represented by insurance companies and pension funds limits the ability of the economy to transform people's savings and business capital into long-term investments necessary for sustainable economic growth and welfare. The in-flow of foreign investments in recent years has fallen drastically due to US/EU sanctions, the drop in oil prices being one of the core economic drivers, and higher-than-average legal risks for doing business in Russia.

ii Impact of specific regional or global events

During 2018 and 2019, in the context of rising US interest rates and the strengthening of the US dollar as well as the US–China trade conflict, market conditions in emerging market economies (EMEs), including Russia, have deteriorated. EMEs faced capital out-flows, a noticeable increase in bond yields, increase in credit spreads and a significant weakening of national currencies.

Foreign ‘appetite’ for Russian risks by investors has also decreased as a result of the general growth of market volatility in EMEs and against the background of the publication by the US authorities of a series of legislative drafts of anti-Russian sanctions. Non-residents in Russia noticeably reduced the volume of their investments in federal loan bonds (FLBs): the ratio of FLBs on the accounts of foreign depositaries in National Settlement Depository in the total volume of the FLBs market decreased from 33.7 per cent on 1 April 2018 to 24.4 per cent on 1 November 2018. The greatest exit intensity was observed in response to the April 2018 sanctions and roll-back of the foreign investors’ carry-trade strategy in June 2018.

1 Alexander Vaneev is a partner and Ilya Sorokin is a counsel at BGP Litigation. They acknowledge and appreciate the substantial work and assistance provided by associates Dimitriy Mednikov and Anton Patkin, and junior associates Anatoly Panin and Mark Politiko in preparing this chapter.
iii Number of formal procedures entered into or exited during this period

According to the report of the Judicial Department at the Supreme Court of the Russian Federation, in 2018 Russian commercial courts received about 100,000 bankruptcy petitions. Almost 40 per cent of these concerned legal entities, whereas the rest had been filed in respect of individuals and individual entrepreneurs (respectively, 55 per cent and 5 per cent). Furthermore, the number of unfinished bankruptcy cases in 2018 increased by about 20 per cent compared to 2017. This suggests a decrease in efficiency of commercial courts and a slowdown of the bankruptcy proceedings.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

The legal framework for bankruptcy of individuals and legal persons is set out in the Civil Code of the Russian Federation (the Civil Code) but mostly in the Federal Law No. 127-FZ dated 26 October 2002 on Insolvency (Bankruptcy) (the Bankruptcy Law).

The Bankruptcy Law provides for the following stages of insolvency proceedings:

a supervision: applied in order to ensure the safety of a company’s property, investigate a company’s financial standing and assets, register creditors’ claims and hold the first meeting of creditors;

b financial rehabilitation: (optional stage) financial recovery of a company by way of approval by courts of a debt repayment schedule;

c external administration: (optional stage) financial recovery of a company through implementation by a court-appointed administrator of a plan of action approved by the court;

d liquidation: the final stage of insolvency proceedings involving realisation of a company’s assets and its liquidation; and

e settlement agreement: could be entered into at any stage of the proceedings in order to terminate the insolvency and agree on a debt repayment schedule.

i The taking and enforcement of security

Pledge, also referred to as ‘mortgage’ in the context of immovable property, is one of the most often used types of security in insolvency proceedings. Another common type of security in bankruptcy is suretyship provided by a third party to secure the obligations of the debtor. However, as suretyship seldom provides a robust guarantee to the creditor in the bankruptcy proceedings the latter is not considered a secured creditor under the Bankruptcy Law.

Russian law provides for two ways of enforcing the pledge: out-of-court enforcement and enforcement upon a court judgment. The former must be directly envisaged in a pledge agreement and is effected by way of applying to a notary for a notarial writ of execution. After the bankruptcy proceedings have been instituted out-of-court enforcement of the pledge is no longer possible.

The pledge is typically enforced via the sale of the pledged property by tender (or public tender in case of court enforcement). A secured creditor is entitled to retain the pledged asset if the tender organiser fails to sell it in the course of the second round of a public tender when the price of the asset is reduced by 10 per cent. A similar right of retention of a secured creditor arises at the stage of the public offering subject to absence of a proper bid at every step of the price decrease.
The secured claim is repaid fully out of the funds recovered from the sale of the pledge in priority to non-secured creditors’ claims. At the very least secured creditors are entitled to 70 per cent of the funds (80 per cent in case of commercial banks).

On the other hand, the rights of the secured creditor are subject to certain limitations, and in particular their voting powers are restricted in the course of financial rehabilitation, external administration, and liquidation procedures. While such proceedings are pending, secured creditors are entitled to vote on only the following points:

a. election of an insolvency administrator or a self-regulatory organisation of insolvency administrators;
b. recourse to a court for removal of an insolvency administrator; and
c. recourse to a court for termination of the liquidation proceedings and returning to external administration.

Notably, at the stage of financial rehabilitation or external administration the secured creditor may elect to forego enforcing the pledge in return for the same voting rights as are given to non-secured creditors. Similarly, should a court refuse enforcement of a pledge at the financial rehabilitation or external administration stage, secured creditor’s voting rights become equal to those of a non-secured one.

There is, however, no limitation on the voting rights of the secured creditors in the bankruptcy proceedings concerning natural persons.

ii. Duties of directors of companies in financial difficulties

Under Russian law, the CEO, as well as members of the management bodies of a company, has a general duty to act reasonably and in the company’s interests. Although the Civil Code does not set out particular duties of a company’s directors towards its creditors, these could be derived from the Bankruptcy Law.

In particular, the CEO is obliged to file for bankruptcy petition within one month at least one of the following criteria becomes satisfied:

d. the satisfaction of the claims of one or more creditors will make it impossible for a company to perform its payment obligations to other creditors;
e. the enforcement of claims against a company’s assets will significantly affect a company’s operations;
f. a company displays the signs of insolvency or insufficiency of assets; and
g. a company is in default for payment of salaries, retirement benefits or making other payments of a similar kind for more than three months.

Should the CEO fail to file an insolvency petition, he or she risks being subject to secondary liability for the new debts of a company arising after the date when the petition should have been filed. Importantly, the obligation to file for insolvency then shifts to other management bodies of a company, and the Bankruptcy Law sets a 20-day deadline for compliance.

Moreover, under the Bankruptcy Law, the CEO is obliged to provide to a court-appointed insolvency administrator all documents and information in relation to the activity of a company over the last three years. All of the transactions and corporate actions that can be entered into or taken by a company’s directors are subject to the administrator’s approval.

The scope of secondary liability of a company’s directors has recently been substantially expanded. The Bankruptcy Law currently provides that a company’s controlling persons — those who are or were in the three years preceding the loss of solvency entitled to issue
mandatory instructions to a company or otherwise determine its course of actions – could be held jointly and severally liable for a company's obligations if its assets are insufficient to satisfy all creditors' claims and if the insolvency was caused by their acts or omissions. In particular, the Bankruptcy Law lists a number of scenarios when there is a presumption of the insolvency of a company due to actions of its controlling persons:

- a transaction entered into by a company for the benefit of a controlling person resulted in a loss;
- accounting or other reporting documents of a company are missing or misleading, which substantially complicates the insolvency proceedings;
- claims arising out of criminal, administrative or tax offences committed by the company or its management exceed 50 per cent of the total amount of the claims;
- corporate documents that a company was obliged to store are unavailable or have been impaired as of the date of a court decision commencing supervision or declaring a company bankrupt; and
- publicly available registers (those containing the information on legal entities and on insolvency proceedings) do not contain the required information on the company or that information is misleading as of the date of commencing the insolvency proceedings.

It is important that the Bankruptcy Law provides for the mechanism of countering the nominal directorship as a means to protect a controlling person from liability. In particular, the nominal director of a company may be absolved from liability if he or she assists in establishing the real director. Moreover, insolvency administrators, previously often unwilling to trace real directors of a company, are now financially motivated by a kind of ‘success fee’ to do so as well as take any further actions to hold controlling persons liable. The claim for secondary liability may be brought even after the termination of insolvency proceedings, subject to the provisions of the Bankruptcy Law.

Furthermore, a court may find the CEO of a company or its shareholders criminally liable and impose a fine or even a prison sentence of up to six years in cases of deliberate insolvency, fraudulent insolvency or unlawful actions in the course of insolvency proceedings that include the transfer or destruction of a company's assets, forgery of accounting documents and concealing information about a company's assets and obligations.

The CEO of a company, its shareholders or an insolvency administrator may also be subject to administrative liability under the Code of Administrative Offences of the Russian Federation to the extent that the relevant administrative offences do not qualify as crimes. The Code of Administrative Offences provides for fines and disqualification of up to three years for directors and insolvency administrators.

### iii Claw-back actions

The Bankruptcy Law provides that the following persons could challenge transactions of the debtor:

- the insolvency administrator – at their own initiative or upon a resolution of the creditors' meeting;
- a creditor or an authorised body (tax authority) holding more than 10 per cent of the listed claims;
- a group of creditors holding, together, more than 10 per cent of the listed claims; and
- an interim administration of the financial institution.
Claw-back actions could be brought on general grounds for setting aside or annulling the transactions of a debtor set out in the Civil Code or provisions of the Bankruptcy Law, which provides that the following transactions may be challenged:

a suspicious transactions:
  • transactions with unequal consideration; and
  • malicious transactions; or

b preferential transactions.

First, a transaction with unequal consideration is a transaction that had been performed during a year preceding the acceptance of a bankruptcy petition by the court or at any time after such acceptance. Its main element is that the consideration that the debtor receives as a result of such transaction is unequal – meaning that its value is at least 20 per cent less than the average market value – to the consideration received by the creditor.

Second, a malicious transaction is a transaction that had been performed during the three years prior to the acceptance of a bankruptcy petition by the court or at any time after such acceptance, that meets the following conjunctive criteria:

a the transaction caused actual damage to creditors;

b the aim of the transaction was to cause damage to the debtor or its creditors; and

c the other party to the transaction was aware of the detrimental aim of the transaction.

There are several statutory presumptions that are applicable in cases involving malicious transactions.

Presumption of the detrimental aim of the transaction applies if:

a at the moment of performance of the transaction the debtor met the criteria of insolvency (insufficiency of assets); and

b one of the following is true:
  • the transaction is gratuitous;
  • the transaction is an interested party transaction;
  • the transaction is aimed at repayment of a participatory interest to a participant of a debtor, exiting the company;
  • the total value of a property transferred to the other party to the transaction amounts to or exceeds 20 per cent of the book value the debtor's assets;
  • the debtor had changed his or her registered address without notifying the creditors before the transaction took place or had taken other measures to conceal the details of the transaction; or
  • the debtor continues to control the transferred property after the disposal thereof.

Presumption of the other party to a transaction being aware of its detrimental aim applies if:

a the other party to the transaction is an interested party in relation to the debtor;

b the other party to the transaction knew or ought to have known of the impairment of the interests of creditors; and

c the other party to the transaction knew or ought to have known of insolvency of insufficiency of assets of the debtor.

Third, a preferential transaction can be challenged if it had been performed within one month before the acceptance of an insolvency petition by the court or at any time after such acceptance. Should a preferential transaction be aimed at securing the debtor’s obligations
before a certain creditor or result in a change of priority of satisfaction of creditors’ claims and should the creditor know about the debtor’s insolvency or insufficiency of its assets, a look back period for such transaction is six months. There is a statutory presumption that an interested party ought to have been aware of insolvency or insufficiency of assets of the debtor unless proven otherwise.

Transactions that may be challenged upon these grounds are voidable and are not null and void by default; they remain in force until the judgment of a court declaring such a transaction as invalid enters into force. However, an invalid transaction is invalid from the very moment of its conclusion and incurs no consequences save for those connected with its invalidity (e.g., an obligation of the creditor to return the funds or assets received from the debtor to the bankruptcy estate).

The limitation period for filing an application to challenge a suspicious or a preferential transaction is one year. As a general rule, this starts running from the moment when an applicant became aware or ought to have become aware of the transaction at issue.

III RECENT LEGAL DEVELOPMENTS

For the past 10 years, Russian insolvency legislation was subject to constant reform and intense discussion. Many legislation amendments came into force after serious problems in the Russian economy in 2008 and 2014. For example, 37 amendments to the Bankruptcy Law were enacted during the period of 2015–2018. Moreover, the practice of the Supreme Court of the Russian Federation has significantly contributed to new developments of Russian insolvency law alongside legislative amendments.

i Subsidiary liability of controlling persons

In spite of the fact the provisions on subsidiary liability of controlling persons existed in Russian law for a number of years, they were rarely applied within bankruptcy proceedings until recent developments in this field. As of today, the regulation of insolvency proceedings is much more comprehensive and protective of the rights of good faith creditors. After amendments to Russian legislation and developments made by the Plenum of Supreme Court supported by extensive case law of the lower courts the procedure for subsidiary liability of controlling persons is as follows.

If a company’s insolvency was caused by the acts or omissions of its controlling persons and company’s assets are not insufficient to satisfy all creditors’ claims, such persons may be held liable for company’s debts. The term ‘controlling person’ is defined as a person who is or was entitled to give mandatory instructions to a company or otherwise determine company’s actions. The Bankruptcy Law provides for an open-ended list of indicators of such control,
and even a person that has no formal affiliation with a company or its CEO could potentially be recognised as a controlling person in respect of that company. The courts have discretion to determine the existence of such control indicators on a case-by-case basis.

A controlling person against whom a claim for secondary liability has been brought joins the bankruptcy proceedings as defendant. It is important to note that the court at the early stage of the insolvency proceedings may impose an obligation upon such defendant to provide security to cover the likely amount of his or her subsidiary liability.

ii Measures against the influence of affiliated persons on bankruptcy procedure

Affiliates of the debtor may create significant difficulties for good faith creditors. For example, they may initiate bankruptcy proceedings with the purpose of appointing a friendly insolvency administrator or influence the bankruptcy procedure by voting in bad faith at creditor meetings. In recent years the Supreme Court has begun to pay close attention to the claims of creditors affiliated with the debtor and in 2018 there were significant developments in this field.

Although the Bankruptcy Law provides for the priority of creditors’ claims on the debtors’ obligations over the corporate claims of company’s participants, abusive practices were used to avoid these regulations. To bypass this legislative provision, the debtor’s affiliates concealed corporate relations as civil obligations and brought their claims against the debtor along with good faith creditors. Generally, for these purposes the debtor’s affiliates used a loan contract, but the case law on recognition of sales, lease and credit contracts as fictitious transactions has played towards suppression of this practice.

Furthermore, in 2018 the Supreme Court formulated the positions on the issue of subordination of claims of the debtor’s affiliates in bankruptcy:

a the Supreme Court ruled that the company shall not be included in the register of creditor claims of its participant referring to the fact that the debtor made a profit as a result of that transaction; and

b the claims of the debtor’s participant who performed obligations to a good faith creditor under the suretyship agreement instead of the debtor shall be subordinated. In that case, the Supreme Court ruled that claim of a debtor’s affiliate obtained by subrogation shall be subordinated.

Rules of random selection of insolvency administrator shall be applied in cases when a bankruptcy petition was filed by an affiliated creditor or a person who in fact can give binding instructions to the debtor or otherwise determine its actions.

9 Ruling of the Supreme Court of the Russian Federation No. 305-ES16-20992(3) dated 7 June 2018.
11 Digest of case law approved by the Presidium of the Supreme Court of the Russian Federation dated 26 December 2018.
Moreover, the Supreme Court set the tendency to protect good faith creditors by broad interpretation of the restitution mechanism for security obligations. In its decision dated 27 April 2018, the Supreme Court ruled that a suretyship shall be restored after the declaring voidable the preferential transaction, made before the bankruptcy.\(^\text{12}\)

**IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES**

One of the novels of restructuring regulation is the implementation in 2017 of a kind of ‘bail out’ mechanism of preventing major banks’ (considered ‘too big to fail’) insolvency. It is worth mentioning that the banking sector has been one of the hottest in terms of insolvency since the Central Bank of Russia (the Central Bank) has been gradually and consistently improving the quality of the Russian banking market for the latest approximately five years by revoking the banking licence of the banks that it had reasonably viewed to be unstable and lacking liquidity. However, in order to save certain systemically important banks from liquidation and at the same time improve the quality of their assets and their reliability in relation to their depositors and other clients, starting from 2017 the Central Bank has been applying a new mechanism of financial recovery by means of the Fund of Consolidation of the Banking Sector (the Consolidation Fund). The Consolidation Fund’s assets are accumulated through the Central Bank’s infusions. The principal mechanics thereof is that upon the reasonable and well-founded decision of the Central Bank preceded by the detailed inspection of the bank, powers of all its managerial bodies (CEO, boards, general shareholders’ meeting) terminate and such bodies become in fact superseded by the Consolidation Fund’s management company (controlled by the Central Bank). The next step is the reduction of the nominal value of the bank’s issued share capital to one rouble and performance of additional share issuance so that the Central Bank becomes the 99.99 per cent shareholder in such a bank and other shareholders’ stakes are diluted. Further, the Central Bank performs set of actions aimed at restoration of the bank’s liquidity, disposal of its low-quality assets, restructuring of its relations with certain borrowers, depositors, investors and other parties. Other measures may include writing down bank’s subordinated loans, debt securities, and deposits. Finally, upon a bank’s full financial rehabilitation, its shares held by the Central Bank are sold to private investors, or other banks through public trades organised and administered by the Central Bank. One of the major examples of the application of that mechanism is the bailing out of Otkritie Financial Corporation, Promsvyazbank and Asian-Pacific Bank. The aggregate amount of funds utilised by the Central Bank in that mechanism during 2017–2019 is approximately 2 trillion roubles.

Another prominent recent matter was application of the piercing of the corporate veil doctrine in the bankruptcy of Dalniaya Step LLC, a subsidiary of Hermitage Capital private equity fund, which in turn was controlled by HSBC bank at all times material to the case. The case is notable since the bankruptcy proceedings that had been terminated due to Dalniaya Step’s bankruptcy in mid-2000s have been reopened at the application of one of the creditors almost 10 years later due to newly discovered facts. The main reason behind that was that the Dalniaya Step’s insolvency administrator did not employ its best efforts to discover and recover all of the Dalniaya Step’s assets for the benefit of its creditors and was not sufficiently diligent in the course thereof. After investigating Dalniaya Step’s complicated

corporate structure the court came to the conclusion in those ‘new’ bankruptcy proceedings that the ultimate control over Dalniaya Step belonged to the HSBC group. The judgment for payment to Dalniaya Step’s creditors of approximately 1.4 billion roubles was rendered by the lower courts against HSBC and upheld by the Supreme Court in 2017–2018.

V INTERNATIONAL

Although the Bankruptcy law emphasises the priority of international treaties before the national sources of law, Russia is not a party to any international treaty regulating bankruptcy, such as the European Convention on Certain International Aspects of Bankruptcy.

According to the Bankruptcy Law and the practice of Russian courts, recognition and enforcement a final and binding foreign court judgment declaring a debtor insolvent and appointing an insolvency administrator could be sought on the basis of an international treaty or reciprocity. In particular, a declaratory judgment is recognised without the need to bring special proceedings, although the interested party is entitled to object against such recognition before Russian courts within one month after learning of the judgment. Non-final decisions and orders (such as those granting interim measures) are not subject to recognition and enforcement.

As long as a foreign court judgment declaring a debtor insolvent and appointing an insolvency administrator is recognised in Russia, the foreign insolvency administrator is entitled to seize the debtor’s Russian assets or request interim measures in support of foreign insolvency proceedings, seek invalidation of the debtor’s transactions.

Foreign nationals with their COMI in Russia may file for bankruptcy before the Russian courts. However, foreign legal entities are not subject to Russian bankruptcy proceedings. At the same time, under Russian law Russian courts have exclusive jurisdiction over the bankruptcy of Russian nationals and, therefore, would refuse recognition and enforcement of respective foreign court judgments.

VI FUTURE DEVELOPMENTS

After serious developments in the bankruptcy legislation in Russia in the past 10 years, it is unlikely that the current legal regime will be overhauled in the foreseeable future. However, several new amendments have recently been suggested.

The Plenum of the Supreme Court introduced a draft law, according to which claims for the inclusion in the register of creditors will be handled by an insolvency administrator or registrar as opposed to a court. Moreover, this bill provides for the possibility of restoring the term for inclusion in the register of creditor claims if there are valid reasons for doing so.13

Another bill that is currently in the State Duma seeks to introduce a restructuring procedure in Bankruptcy Law. As stated in the document, the essence of the restructuring procedure is that it could partially replace the procedure of supervision, financial recovery and external administration. Furthermore, it provides for the possibility of the debtor to apply for the commencement of this procedure and adoption of a restructuring plan.14

14 Draft law No. 239932-7 on amendments in the Federal Law on Insolvency (Bankruptcy) and certain legislative acts regarding the procedure of restructuring debts in cases of legal entities’ bankruptcy.
I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

Following closely on the heels of the landmark legislative amendments to Singapore’s restructuring and insolvency legal framework in 2017, the Singapore government has continued its efforts to promote Singapore as an international centre for debt restructuring, with the passing of the omnibus Insolvency, Restructuring and Dissolution Act in Parliament on 31 October 2018 (the Insolvency Act). The Insolvency Act is presently expected to come into force on a date to be announced in or around the second half of 2019.

The above legislative developments coincide with the backdrop of a slowing Singapore economy in 2019, which has seen various companies continuing to pursue restructurings and workouts via the existing court-supervised insolvency frameworks. In turn, the Singapore courts have continued to develop the law, including handing down a number of key decisions that have provided further guidance and clarification on Singapore’s legal framework for restructuring and insolvency.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Restructuring and insolvency legal framework

At present, until the Insolvency Act comes into force in or around the second half of 2019, the main source of legislation in Singapore governing corporate restructuring and insolvency remains the Companies Act, with certain provisions in the Bankruptcy Act imported into the Companies Act with necessary modifications. Both Acts are supplemented by various subsidiary legislation. Under the framework, there are three broad areas of court-supervised insolvency and restructuring procedures for companies: schemes of arrangement, judicial management and liquidation. Insofar as certain substantive changes to the existing legal framework will be effected by the Insolvency Act (when it comes into force), these will be discussed in Section III.i below.

Schemes of arrangement

Part VII of the Companies Act sets out the statutory framework for schemes of arrangement. A scheme of arrangement is a statutory mechanism for securing agreement between a company and its creditors, members or shareholders in respect of a compromise or arrangement without
the need for unanimous consent. Thus, under the scheme, creditors may, for example, agree to rearrange or extinguish debts owed by the company to them in part or in whole, or to defer repayment of the same. The court plays a supervisory role at two key junctures: first, in granting leave for a creditors’ meeting to be convened to consider the scheme of arrangement, and second, in sanctioning the scheme of arrangement (which has been approved by the creditors).

A crucial tool is the availability of the statutory moratorium. A moratorium may be granted to restrain further proceedings in any action or proceeding against the company. The 2017 legislative amendments also introduced an ‘enhanced’ moratorium regime, under which an interim 30-day moratorium arises automatically upon an application being made for a moratorium. The enhanced moratorium also restrains secured creditors from enforcing their security, can have in personam worldwide effect, and can be extended to related companies.

Other provisions include the availability of cross-class cramdowns on minority dissenting creditors where the requisite majority is obtained in respect of all creditors as a whole, provided that the scheme does not discriminate unfairly between the classes of creditors and is fair and equitable. The court can also approve a pre-packaged scheme where it is satisfied that the requisite majority of creditors would have approved the scheme, therefore saving time and costs.

Finally, the court is empowered to confer various levels of ‘super priority’ for rescue financing in certain circumstances. In order to obtain an order under Section 211E(1)(a) of the Companies Act, the applicant must show that it has expended reasonable efforts to secure other types of financing without super priority. For an order under Section 211E(1)(b) of the Companies Act, the debtor must demonstrate reasonable efforts have been undertaken to explore other types of financing without priority status. Evidence must be placed before the court of, for example, failed negotiations. Other considerations include whether: (1) the proposed financing is in the exercise of sound and reasonable business judgment; (2) alternative financing is available on any other basis; (3) such proposed financing is in the best interests of the creditors; (4) any better proposals are before the Court; (5) the proposed financing is necessary to preserve the assets of the estate and is necessary, essential and appropriate for the continued operation of the debtors’ business; (6) the terms of the proposed financing are fair, reasonable and adequate; and (7) the financing agreement was negotiated in good faith and at arm’s length.

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3 Section 210(1) of the Companies Act.
4 Section 211B(8) of the Companies Act.
5 Section 211B(1) of the Companies Act.
6 Section 211B(5) of the Companies Act.
7 Section 211C of the Companies Act.
8 Section 211H of the Companies Act.
9 Section 211I of the Companies Act.
10 Section 211E of the Companies Act.
11 Re Attilan Group Ltd [2018] 3 SLR 898 (Re Attilan).
12 Re Attilan.
13 Re Attilan.
14 See further at Re Attilan.
Judicial management

Part VIIIA of the Companies Act sets the statutory framework for judicial management. Judicial management may be utilised where a company is, or is likely to become, unable to pay its debts, either as a tool for corporate rescue or to carry out a more advantageous realisation of a company’s assets than would be possible in a winding up. In judicial management, a judicial manager, who is appointed to replace the company’s existing management, is empowered to do all such things as may be necessary for the management of the affairs, business and property of the company. After a judicial management order is made, the judicial manager will formulate a statement of proposals for the rehabilitation of the company or the realisation of its assets, which must be approved by the company’s creditors.15

A statutory moratorium arises automatically upon an application being made for judicial management,16 which is extended upon the making of a judicial management order.17 As in the scheme of arrangement enhanced moratorium, the judicial management moratorium restrains secured creditors from enforcing their security. ‘Super priority’ in rescue financing is also available in the judicial management regime.18

Liquidation

Under the Companies Act, a company may be wound up compulsorily by the Court or voluntarily.19 In a compulsory liquidation, parties with standing under the Companies Act, including creditors of a company,20 may apply to the Court for an order that a company be wound up.

The Companies Act provides a list of grounds upon which the Court may make an order to wind up a company,21 including that the company is ‘unable to pay its debts’.22 A statutory presumption that the company is unable to pay its debts arises if (1) a statutory demand for a sum exceeding S$10,000 has been duly issued to the company and the company for three weeks thereafter neglects to pay the sum or to secure or compound for it to the creditor’s reasonable satisfaction, the company is deemed to be unable to pay its debts;23 or (2) if an execution or other process issued on a judgment of any court against the company is returned unsatisfied in whole or in part, the company is also deemed to be unable to pay its debts.24

The creditor can also prove that the company is unable to pay its debts (including contingent and prospective debts, if any).25 In general, courts typically deploy two tests – the ‘cash-flow’ test (i.e., the company is unable to pay its debts as they fall due) and the ‘balance-sheet’ test (i.e., the company’s liabilities, including contingent and prospective liabilities, exceed its assets). All evidence that may appear relevant to the question of insolvency will be considered.26

15 Sections 227M and N of the Companies Act.
16 Section 227C of the Companies Act.
17 Section 227D(4) of the Companies Act.
18 Section 227HA of the Companies Act.
19 Section 247 of the Companies Act.
20 Section 253 of the Companies Act.
21 See Section 254 of the Companies Act for the full list.
22 Section 254(1)(e) of the Companies Act.
23 Section 254(2)(a) of the Companies Act.
24 Section 254(2)(b) of the Companies Act.
25 Section 254(2)(c) of the Companies Act.
The court may make an order to stay or restrain further proceedings against the company (including the enforcement of security) at any time after the making of a winding-up application.\textsuperscript{27} Further, upon the winding-up order being made, no action or proceeding shall be commenced without the leave of the court.\textsuperscript{28}

In a voluntary liquidation, the court need not get involved. There are two types of voluntary liquidation – a creditors’ voluntary liquidation (CVL) and a members’ voluntary liquidation (MVL). As a matter of procedure, both CVL and MVL are commenced by the company resolving by special resolution (i.e., by a majority of not less than three-quarters) that it be wound up voluntarily.\textsuperscript{29} If the company’s directors are able to make a declaration that the company will be able to pay its debts in full within a period not exceeding 12 months from the commencement of winding up, the liquidation begins as an MVL.\textsuperscript{30} If not, the liquidation begins as a CVL. A key difference between the two is that in a CVL, the company must convene a meeting of creditors,\textsuperscript{31} where the creditors will be able to nominate a liquidator that will prevail over the company’s nomination.\textsuperscript{32}

\textbf{ii Statutory avoidance provisions and clawback}

Any disposal of the company’s property made after the commencement of winding up is void,\textsuperscript{33} though the court can prospectively or retrospectively validate such disposal.\textsuperscript{34} Additionally, certain transactions entered into by the company prior to the commencement of liquidation may be void or voidable. An ‘unfair preference’, which is a transaction that has the effect of putting a creditor in a better position than the creditor would otherwise have been in the event of the company’s insolvency had the preference not been given, may be set aside if the transaction was entered into in the six months preceding the commencement of winding up.\textsuperscript{35} Where the person preferred is a ‘person connected with the company’ (including directors of the company), this period is two years. An unfair preference must have been made with the intention to prefer – an intention that is presumed if the transaction is entered into with a person connected with the company.

An ‘undervalued transaction’, including transactions that were entered into for no consideration, or for a value of which (in money or money’s worth) is significantly less than the value (in money or money’s worth) of the consideration provided, may be set aside if entered into within the five years preceding the commencement of winding up.\textsuperscript{36} However, the transaction will not be set aside if it is proven that the transaction was entered into in good faith for the purpose of carrying on the company’s business, and there were reasonable grounds for believing that the transaction would benefit the company.\textsuperscript{37}

\textsuperscript{27} Section 258 of the Companies Act.
\textsuperscript{28} Section 262(3) of the Companies Act.
\textsuperscript{29} Section 290(1)(b) of the Companies Act.
\textsuperscript{30} Section 298 of the Companies Act.
\textsuperscript{31} Section 296 of the Companies Act.
\textsuperscript{32} Section 297(1) of the Companies Act.
\textsuperscript{33} Section 259 of the Companies Act.
\textsuperscript{34} Centaurea International Pte Ltd (in liquidation) v. Citus Trading Pte Ltd [2017] 3 SLR 513.
\textsuperscript{35} Section 329 of the Companies Act, read with Section 99 of the Bankruptcy Act.
\textsuperscript{36} Section 329 of the Companies Act read with Section 98 of the Bankruptcy Act.
\textsuperscript{37} Companies (Application of Bankruptcy Act Provisions) Regulations, r 6.
Any person who has been found to have been knowingly party to the company carrying on business with the intent to defraud creditors or for a fraudulent purpose may be held personally liable for all the company’s debts and liabilities, and guilty of a criminal offence.

A floating charge entered into within six months of the commencement of the winding up is valid to the extent of any cash paid to the company in consideration for the charge, unless it is proven that the company was solvent immediately after the creation of the charge.

The above applies similarly in judicial management, with the necessary modifications.

iii The position of secured creditors

When entering into a loan transaction with a company that is insolvent or near insolvency, secured creditors should be mindful of the statutory avoidance provisions discussed in Section II.ii.

Further, any creditor intending to secure the debt with a floating charge should take care to ensure the floating charge is registered within 30 days, failing which the floating charge is void as against a liquidator.

The moratoria that apply to restrain the enforcement of security in schemes of arrangement, judicial management and liquidation has been discussed above at Section II.i.

As to the ranking of creditors in distribution, a creditor with a registered floating charge is subordinated to a creditor with a fixed charge and certain statutory preferential debts, but ranks ahead of unsecured creditors.

iv Directors’ duties in insolvency

A director is under a duty to act honestly and use reasonable diligence. Where the company is insolvent or near insolvency, directors must additionally take into account the interests of the company’s creditors to ensure the company’s assets are not dissipated. As long as there are reasons to be concerned that the creditors’ interests are or will be at risk, directors ought to have due regard to their interests.

A director who is knowingly a party to the company contracting a debt of which there was no reasonable or probable ground or expectation that the company would be able to pay off such debt could be convicted of a criminal offence. Any person who has been convicted for insolvent trading may also be held personally liable for the repayment of that debt.

Further, while the statutory avoidance provisions discussed in Section II.ii are not per se expressed to impose duties on directors, a director would likely be liable for a breach of...
fiduciary duties where there has been an adverse finding under the statutory avoidance. 49
Claims for breaches of common law fiduciary duties may be brought notwithstanding that
the relevant time limit under statutory avoidance provisions have passed. 50

III  RECENT LEGAL DEVELOPMENTS
i  The omnibus Insolvency Act
The aims of the omnibus Insolvency Act are threefold: (1) to consolidate Singapore’s
corporate and personal insolvency restructuring laws into a single enactment, so as to reduce
inconsistencies and uncertainties by eliminating the need for cross-referencing between
different statutes; (2) to enhance Singapore’s restructuring and insolvency laws, as part of
the concerted move to promoting Singapore as an international debt restructuring centre,
thereby creating opportunities for professional services in Singapore; and (3) to introduce a
consolidated regulatory regime for insolvency practitioners.51

One significant change introduced in the Insolvency Act is the restriction of the
operation of ‘ipso facto’ clauses in contracts. When it comes into force, the Insolvency Act will
prevent any person from terminating an agreement (including security agreements), claim an
accelerated payment, or terminate or modify any right or obligation under such agreement,
by reason only that (1) an application has been made to court for a scheme of arrangement
(or a moratorium under the scheme of arrangement framework) or judicial management;
or (2) the company is insolvent.52  The intention is to facilitate attempts by companies to
restructure, by protecting valuable commercial contracts from being terminated.53  Certain
types of contracts will be excluded from the new ipso facto provisions, including ship charters,
and eligible financial contracts and contracts that are likely to affect the national interest or
economic interest of Singapore, to be prescribed by regulations.54  The applicable regulations
have not yet been issued at this time. In addition, if a particular contract does not fall within
an excluded category, an affected counterparty may apply to the court for relief on the basis
of significant financial hardship.55

When the Insolvency Act comes into force, a secured creditor must realise its security
within 12 months from the commencement of winding up in order to be entitled to claim
interest on secured debt (a similar provision also applies in judicial management).56  Further,
a new concept of ‘termination’ of winding-up proceedings (and not merely a ‘stay’) has been
introduced, and the court is empowered to give directions for the resumption of management
and control of the company by its officers in such termination.57  The Insolvency Act also
introduces a new concept of ‘wrongful trading’, intended to replace the insolvent trading

51  Ministry of Law, Second Reading Speech by Senior Minister of State for Law, Mr Edwin Tong, on the
52  Section 440 of the Insolvency Act.
53  The Insolvency Bill Second Reading Speech.
54  Section 340(5) of the Insolvency Act.
55  Section 340(4) of the Insolvency Act.
56  Section 223 of the Insolvency Act.
57  Section 186(3) of the Insolvency Act.
regime discussed earlier.\textsuperscript{58} Under this, any person (not just a director) who was party to the company trading wrongfully may be declared personally liable for the company’s debts or liabilities.\textsuperscript{59} The civil liability is no longer contingent on criminal liability being found.

An out-of-court mechanism to commence judicial management (by majority vote of the company’s creditors) has also been introduced,\textsuperscript{60} which is intended to reduce expenses, formality and potential delay.\textsuperscript{61} In recognition of the increasing use of third-party litigation funding, a judicial manager is now expressly empowered to assign the proceeds of an action arising under claims by the company for inter alia undervalue transactions, unfair preferences, fraudulent or wrongful trading, or misfeasance or breach of trust or duty.\textsuperscript{62} By contrast, the position in liquidation remains that a liquidator has the power to sell or assign the company’s things in action (including causes of action) to third-party litigation funders,\textsuperscript{63} but this excludes causes of action which arise only in the context of liquidation that can only be pursued by a liquidator, for example, claims under statutory avoidance law provisions.\textsuperscript{64}

In relation to the schemes of arrangement framework, the proposed amendments have been confined to clarifying and fine-tuning the extensive amendments introduced in 2017. A carveout to the enhanced moratorium regime has been introduced to exclude the commencement and continuation of certain proceedings prescribed by regulations.\textsuperscript{65} The intention is to exclude certain types of proceedings in a targeted manner where necessary, for example, to exclude writs for an action \textit{in rem} against vessels.\textsuperscript{66} Further, the Insolvency Act also clarifies that the cross-class cramdown power as against unsecured creditors is available so long as persons with subordinate priority to the dissenting class, or any member of the company, do not receive or retain any property of the company.\textsuperscript{67} This therefore clarifies that there is no requirement for shareholders to voluntarily divest their shares before any cross-class cramdown can operate.\textsuperscript{68}

The new Insolvency Act also introduces a unified regime of mandated licensing, qualifications, standards and disciplinary measures for all insolvency practitioners in Singapore.\textsuperscript{69}

\section*{iii Case law}

\textbf{Factors which a Singapore court will consider in recognising foreign insolvency proceedings}

In 2017, Singapore adopted the UNCITRAL Model Law on Cross-Border Insolvency (the UNCITRAL Model Law), with certain modifications under the Tenth Schedule of the

\begin{itemize}
  \item \textsuperscript{58} The Insolvency Bill Second Reading Speech.
  \item \textsuperscript{59} Section 239 of the Insolvency Act.
  \item \textsuperscript{60} Section 94 of the Insolvency Act.
  \item \textsuperscript{61} The Insolvency Bill Second Reading Speech.
  \item \textsuperscript{62} First Schedule of the Insolvency Act at paragraph (f).
  \item \textsuperscript{63} Section 272(2)(c) of the Companies Act.
  \item \textsuperscript{64} \textit{Solvadis Commodity Chemicals Gmbh v. Affert Resources Pte Ltd} [2018] 5 SLR 1337.
  \item \textsuperscript{65} Section 64(12)(b) of the Insolvency Act.
  \item \textsuperscript{66} The Insolvency Bill Second Reading Speech.
  \item \textsuperscript{67} Section 70(4)(b)(ii)(B) of the Insolvency Act.
  \item \textsuperscript{68} The Insolvency Bill Second Reading Speech.
  \item \textsuperscript{69} Part 3, Division 3 of the Insolvency Act.
\end{itemize}
Companies Act (the Singapore Model Law). The Singapore Model Law empowers Singapore courts to recognise foreign main proceedings or foreign non-main proceedings, and grant relief in aid of the recognised foreign main or non-main proceeding.

In Re: Zetta Jet Pte Ltd and others (Asia Aviation Holdings Pte Ltd, intervener) [2019] SGHC 53, the court was asked to reconsider an earlier decision, refusing to grant full recognition to a trustee appointed under Chapter 7 proceedings in the US on the grounds that such recognition would be contrary to public policy. The court considered, for the first time, the factors for the determination of a company’s centre of main interests (COMI) under the Singapore Model Law. The court espoused the following: (1) the assessment of where a company’s COMI is should be made with reference to the date of the application being made to Court for recognition of a foreign proceeding; (2) as a starting point, the company’s COMI is presumed to be the location of its registered office, though this can be proved otherwise by showing evidence to the contrary – where the scale does not clearly tip either way, the location of the registered office will be taken to be the COMI by default; (3) the factors considered (which should have an element of settled permanence or intended permanence) must be objectively ascertainable by third parties generally, with a focus on creditors and how likely a creditor would weigh a particular factor in his mind; (4) if a company is clearly involved in cross-border activities, the location of its assets or operations may be less significant; (5) in assessing the COMI, the court may consider the activities of the wider group of companies to which the company belongs; and (6) relevant factors include the location from which control and direction was administered, the location of clients, creditors, employees and operations, dealings with third parties, and governing law – but the location of a foreign trustee in insolvency proceedings should not be taken into account.

Schemes of arrangement: key developments

In 2019, the Singapore High Court granted super-priority status to rescue financing for the first time since the 2017 amendments, having declined to do so in an earlier case. Asiatravel.com Holdings Ltd had hired a financial advisor to seek financing, and sought financing from potential investors, existing bank lenders, and distressed situations funds to no avail. The Court accepted that the company would not be able to secure rescue financing without the Court granting super-priority status for such financing. Eventually, the Court granted the investor a super-priority order over all preferential and unsecured debt. The Court also accepted that super-priority status could be granted to rescue financing on non-monetary terms – the financing took the form of cash injection, as well as hotel room and theme park tickets (being sellable inventory essential to the company’s business).

In Pathfinder Strategic Credit LP and BC Investment LLC v. Empire Capital Resources Pte Ltd [2019] SGCA 29, the Court of Appeal overturned an earlier decision of the High Court granting leave for a company to convene a creditors’ meeting for a proposed scheme
of arrangement,\textsuperscript{75} on the grounds that the company had made insufficient disclosure. The Court held that it will refuse leave solely on the grounds of inadequate disclosure only in clear and obvious cases. The sufficiency of disclosure would depend on what is reasonable in the circumstances, and relevant factors include the size and resources of company, size of debt, urgency of application, reasons for inability to provide further information. In this case, the Court held disclosure was woefully inadequate – the applicant company had only disclosed audited financial statements of its parent company up to 2014, with all other financial statements being unaudited. No financial statements whatsoever in relation to the companies in the group whose debts would actually be compromised under the scheme were disclosed. Lastly, the applicant company had not even disclosed its own financial statements.

\textit{In Re IM Skaugen SE and other matters} [2019] 3 SLR 979, the Court clarified the requirements to be fulfilled by companies applying for a moratorium under Section 211B of the Companies Act. Where the company applying for the moratorium has proposed a scheme, it must show evidence of support from the company’s creditors for the proposed scheme, and an explanation of how such support would be important for the success of the proposed scheme.\textsuperscript{76} Where the company applying for the moratorium has not proposed a scheme but intends to do so, it must to show evidence of support from the company’s creditors for the moratorium, an explanation of how such support would be important for the success of the intended scheme, and a brief description of the intended scheme.\textsuperscript{77} The Court should refrain from undertaking a vote count – rather, the quality of support is important, though the opposition of a majority creditor would not necessarily be fatal to an application. In weighing creditor support in the context of a group restructuring, the Court may have regard to the overall support of the group’s creditors (and not just the applicant company’s creditors) for group restructuring efforts. The Court also clarified that where an applicant seeks in personam worldwide effect such that the moratorium extends to any act or person ‘within the jurisdiction of the Court, whether the act takes place in Singapore or elsewhere’,\textsuperscript{78} the application must identify the specific act or party which is sought to be restrained.

\textbf{Judicial management: key developments}

The judicial management of Swiber Holdings Limited (Swiber) continued in 2018 through to 2019. The above matter has raised novel questions on certain aspects of judicial management, which came before the Court on two separate occasions.

\textit{In Re Swiber Holdings Ltd} [2018] 5 SLR 1358, the Court considered the position of bond investors, who hold their interests through nominees, custodians or trustees, in voting. The Court held that such bond investors did not have a direct contractual relationship with Swiber, the bond issuer, and accordingly only the trustee was entitled to vote in a judicial management. Procedurally, the trustee would vote one vote for, and one vote against, with the trustees’ voting value split to reflect the value of bond investors voting for and against. The Court also observed that, in a scheme of arrangement, the bond investors would be able to vote directly as contingent creditors of the bond issuer.

\textit{In Re Swiber Holdings Ltd and another matter} [2018] 5 SLR 1130, the Court clarified that a creditor whose claim against a debtor company is secured by third party security is not

\textsuperscript{75} \textit{Re: Empire Capital Resources Pte Ltd} [2018] SGHC 36, discussed in last year’s edition.

\textsuperscript{76} Section 211B(4)(b) of the Companies Act.

\textsuperscript{77} Section 211B(4)(a) and (b) of the Companies Act.

\textsuperscript{78} Section 211B(6) of the Companies Act.
considered a secured creditor for the purposes of filing a proof of debt and voting in a judicial management – even where the third party is a subsidiary or associate of the debtor company. Where the third party security is realised, or payment is received from the third party after the creditor lodges its proof of debt, and the company under judicial management is a principal debtor, the creditor can maintain its proof for the full value of the debt, unless (1) he receives the full value of the debt; or (2) he receives the full value of the part of the debt guaranteed. Where, however, the company under judicial management is a guarantor, the debtor will have to reduce its proof correspondingly. In both scenarios, the cut-off date is the day before the date of payment of dividends.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

In the restructuring of home-grown water and energy solutions provider, Hyflux Ltd (Hyflux), the company, which had earlier obtained a moratorium under Section 211B of the Companies Act,79 fended off attempts by its creditors to place it under judicial management after a potential investment deal with a white knight fell through earlier in April 2019.80 The Singapore Public Utilities Board has taken over control of one of the company’s key assets, the largest desalination plant in South-East Asia, in May 2019,81 though the implications this may have on Hyflux’s restructuring remains to be seen. As at the time of writing, Hyflux’s moratorium period had been extended by the High Court to 2 August 2019.82 As for the judicial management of Swiber (discussed earlier), a statement of proposals has been made by the judicial managers and approved by the company’s creditors.83

proposal envisions a foray into the Vietnamese power market (a first for the company). It also contemplates the issuance of shares in a new Swiber-owned entity to Swiber’s current creditors. Swiber’s judicial management order remains in force until 31 December 2019.

V  INTERNATIONAL

Since Singapore’s adoption of the Singapore Model Law, Singapore courts have been empowered to grant recognition for foreign main or non-main proceedings in accordance with the UNCITRAL Model Law. Foreign main proceedings qualify for more extensive relief than foreign non-main proceedings – for example, an automatic stay and suspension of actions or proceedings against the debtor’s property arises upon recognition of a foreign main proceeding.

The enhanced moratorium in a scheme of arrangement (see Section II.i above), which may be expressed to have in personam worldwide effect, has also raised interesting questions on how foreign courts may view such a moratorium. In 2019, it was reported that an English court became the first foreign court to recognise Singapore’s extraterritorial moratorium. On the other hand, a Hong Kong court doubted that Hong Kong courts would be able to recognise the effect of such an extraterritorial moratorium in Hong Kong (which has not enacted the UNCITRAL Model Law).

The 2017 legislative amendments had also made it possible, for the first time, for a foreign company to be placed in judicial management in Singapore if it has a substantial connection with Singapore. Following these amendments, China Sports International Limited was the first foreign company to be placed into judicial management in Singapore. A relevant factor in the court determining a ‘substantial connection’ was whether Singapore was the COMI. As the proceedings involved a Singapore-listed entity, the court found that this was sufficient to establish that Singapore was the COMI, because the company was subject to regulation in Singapore, and Singapore law governed the preparation and audit of its accounts.

VI  FUTURE DEVELOPMENTS

The coming into force of the Insolvency Act in or around the second half of 2019, together with the accompanying subsidiary legislation and regulations, is expected to have a significant impact on Singapore’s restructuring and insolvency landscape, and it is anticipated that these developments will continue to be closely watched by the relevant stakeholders including lenders, borrowers and insolvency practitioners.
I  OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

i  Liquidity and state of the financial markets
The global excess of liquidity is not an exception in the Spanish financial market. Banks and, more significantly, investors such as investment funds (opportunistic and long term), institutional investors such as pension funds and others have deployed a substantial amount of liquidity in the Spanish market.

The main focus of those investments has been real estate, either by means of direct acquisitions or through the acquisition of NPLs from the Spanish banks (with NPL transactions amounting to around €50 billion in the last 12 months), and they have also invested in industrial and telecom companies.

Banks and non-traditional lenders are also providing more short-term capital and credit lines to SMEs and consumers. This is pushing the economy significantly. In addition, the good signs and macro data of the Spanish economy brings optimism to investors, and unless political instability affects growth and confidence, it should be expected that the level of investment in Spain shall remain for all sectors in the coming years.

Questions surround the international trade war, the challenges faced by the European Union and uncertainties regarding its future, the signals of economic downturn, and the effect of an eventual interest rate rise in an economy that is much more indebted than in 2007 and 2008. However, both the banks and financial sector, and the supervising authorities are now better prepared at the national and international level to face the next financial crisis.

ii  Impact of specific regional or global events
There are two measures related to the European Central Bank that may have a direct impact on the Spanish financial markets. The reduction of the ECB’s TLTROs and a potential increase of the interest rates will affect a market that is still dominated by the traditional banking entities. This is helping alternative lenders take over a niche of the marketspace left that banks cannot finance because of internal limitations imposed after the last real estate crisis.

Brexit, Trump’s presidency, the political crisis in Catalonia, the new Spanish and Italian governments, the euroscepticism across the EU and many other things are factors that no doubt may have an impact in capital markets sooner or later; however, it seems that money is not scared and is getting used to permanent global and political uncertainties, both at regional and global level. In Spain, for the moment and except for short periods, it is business as usual.
and companies are surfing the waves of growth and non-expensive capital. The Spanish real estate market continues its recovery. Despite this, we have not reached maximum price levels, rents are at their highest levels and we could be reaching the end of the current cycle.

### iii Market trends in restructurings

For many years the Spanish Insolvency Act (SIA) proved extremely inefficient for protecting going-concern value and enabling the turnaround of economically viable companies in financial trouble. Most insolvency proceedings in Spain ended up in debtor’s liquidation (which, nonetheless, permitted to maintain the going concern business through its sale to the best bidder). As a result of the ‘extend and pretend’ processes, normally by the time the company was entering into insolvency proceedings, it was too late for its turnaround and recovery rates for creditors were low (less than 10 per cent of the claims for unsecured creditors in most cases).

The 2014 and 2015 amendments to the SIA promoted refinancing schemes at pre-insolvency stages, introduced certain restructuring tools and new rules that provided out-of-court solutions and reshaped it into a more flexible framework. At that stage, it is revolutionary under Spanish law that dissenting creditors holding financial claims could be crammed down by a majority of creditors outside a full-blown insolvency proceeding. Since then, for instance, it was not necessary to rely on foreign jurisdictions and instruments such as the ‘English scheme’ to achieve successful financial out-of-court workouts of Spanish companies.

For the past years, we have seen very large and well-known Spanish companies and conglomerates (particularly, in the real estate and construction sector) involved in either pre-insolvency and out-of-court procedures or insolvency proceedings (e.g., Martinsa Fadesa, Metrovacesa, FCC, Abengoa, Grupo Isolux-Corsán, Bodybell, Celsa, Comsa, Codere, Prisa, Pescanova). During 2019 and for the next few years, we do not anticipate many distressed restructurings exceeding €1 billion. We rather expect restructuring amounts to be around €300 to €500 million owing to the large number of small- and medium-sized enterprises across Spain.

The alternative lenders and private debt funds are taking a relevant role in Spanish restructurings. In many cases, they are replacing the banks’ positions and becoming catalysts of restructurings. Indeed, funds are more flexible and may grant new money and even working capital and short-term credit lines. Typically, we have seen the acquisition of the majority of the financial debt to cram down the banks and impose new terms to minority dissenters and subsequently, capitalise all or part of the financial debt or transform it into participative loans. Finally, funds are also participating in restructuring procedures by financing the acquisition of borrowers’ debt at discount and once the business is sound again, they are usually replaced by traditional banks.

### iv Number of formal procedures

Both creditors and debtors prefer out-of-court and pre-petition restructuring tools (individual and collective refinancing agreements, court-sanctioned refinancings (i.e., judicial homologations or ‘Spanish schemes’) and out-of-court payment agreements) rather than moving into formal judicial insolvency proceedings. In general, recovery rates are normally much higher at pre-insolvency stages.
The number of insolvency proceedings in 2018 stabilised at 5,700 cases. However, if we compare it with 2014 when there were almost 6,500 cases, it shows a relevant decrease, but an increase compared to 2017 (5,300). The regions of Catalunya, Madrid and Valencia still account for half of the total cases.

Since 2014, there have been a substantial number of judicial decisions of homologation of Spanish schemes. Many of these procedures have been contested and objected since the SIA did not provide a clear solution for some complex situations and, therefore, the matter was subject to interpretation. Five years later, many of these controversial issues have been resolved by Spanish courts, and the framework is now much better defined.

There is a useful public register named Registro Público Concursal (Insolvency Register), which allows anyone to check the status of any Spanish entity involved in insolvency proceedings and its judicial resolutions online (see https://www.publicidadconcursal.es/concursal-web/).

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

1 Introduction to the insolvency regime

The SIA foresees a *concurso* (the full Spanish insolvency proceeding) for companies that are not able (or expect not to be able) to regularly pay their debts as they fall due. The directors of a company or the debtor must file for insolvency within two months of the date on which they became aware or should have become aware of the insolvency situation.

Unlike the US Bankruptcy Code, debtors (or creditors) do not have to make a decision between reorganisation (Chapter 11) or liquidation (Chapter 7) upon seeking judicial protection. Every insolvency proceeding begins with the ‘common phase’, which, however, may be coupled with other actions if debtor’s filing attaches, for instance, a prearranged proposal of composition agreement or a draft liquidation plan with a binding offer to acquire the business as a going concern. The common phase starts with the judge appointing an insolvency administrator (an independent third party – creditors have no say), who will be in charge of determining debtor’s estate and list of creditors (by producing the draft insolvency report). The insolvency administrator also oversees management of debtor’s business (default rule in voluntary cases) or steps into the shoes of directors if so determined by the court (default rule in involuntary cases).

Creditors or any interested party may challenge the estate or the list of creditors. The common phase will not end until the court resolves these challenges, unless they represent less than 20 per cent of assets or claims, in which case the court may decide to proceed to next phase in order to reduce the length of the proceedings and preserve the value of the assets. Unless the debtor petitions liquidation, the proceeding will move onto the composition phase as a default rule (no other party can petition liquidation, except the insolvency administrator when business shuts down).

Summary insolvency proceedings may apply if the debtor: (1) has fewer than 50 creditors or its assets or liabilities do not exceed €50 million; (2) files with an early composition agreement proposal or a composition agreement with a corporate restructuring; or (3) files for insolvency with a draft liquidation plan and a binding offer.
ii Article 5 bis notice (automatic stay)

Under Spanish insolvency law, directors must file for concurso within two months from directors’ actual or due awareness of debtor’s inability to regularly pay its obligations as they come due. Failure to comply with this duty may have negative consequences for directors if they are found to have willfully or grossly negligently created or deepened insolvency (a late petition is a rebuttable presumption thereof). Directors’ liability is analysed within the frame of insolvency classification section, which kicks in if the composition agreement sets forth haircuts or term extensions of at least a third of a year or three years for all classes or in the event of liquidation. In particular, in the event of liquidation directors may be liable for the impaired claims accrued as from the onset of insolvency.

Having said that, debtors may earn an additional four-month period to keep on negotiating a refinancing agreement out of court, an out-of-court payment scheme or a prearranged composition agreement. Article 5 bis of the SIA establishes the proceeding to earn this safe harbour for directors. The debtor must serve notice with the court that would entertain concurso within two months from the onset of insolvency. The court merely acknowledges receipt (this is not an adversarial proceeding). The debtor has three months to keep on negotiating, as a concurso petition must otherwise follow during the fourth month. Thus, considering that the debtor has two months to file for concurso or serve an Article 5 bis notice, borrowers have at the end six months from the onset of insolvency to negotiate out of court instead of filing for concurso. In practice, so long as suppliers and workers are supportive or controlled, debtors may extend this period through standstill agreements (even seeking homologation thereof to bind dissidents as in the first Abengoa case; however, this remains highly controversial).

During this four-month period, the court shall not admit petitions for involuntary concurso (the debtor has preference to file voluntarily until the end of the fourth month).

Article 5 bis notice also establishes an automatic stay, though limited to enforcement actions (e.g., security interests, monetary judgments – not payment, setoff, etc.) over assets necessary to continue the ordinary course of business. A standstill entered into between 51 per cent of the financial claims impedes lenders to initiate enforcement actions over any assets. Yet, public claims (taxes, social security, etc.) are not affected by this automatic stay. Security interests governed by the financial collateral special regime or perfected on assets not located in Spain also escape this automatic stay (if the collateral is located outside the EU, the ability to escape the automatic stay shall rely on local insolvency law).

The debtor is allowed to file one Article 5 bis notice per year. This is consistent with the SIA’s goal of promoting restructuring alternatives to concurso, but so long as the restructuring alternatives are actually suitable to remove financial distress.

iii Clawback actions (avoidance)

According to Article 71 SIA, debtor’s acts and contracts detrimental to the estate that were performed within the two years prior to the declaration of insolvency may be avoided, even in the absence of fraud or intent. The SIA establishes certain rebuttable and non-rebuttable presumptions of detriment to the estate.

The SIA also establishes certain safe harbours, mainly: (1) acts and contracts pertaining to the ordinary course of business and at arm’s length terms; (2) acts within the scope of special regulation over payment and clearing and liquidation systems for securities and hedging instruments; (3) security interests granted in favour of the salary guarantee fund
(FOGASA) or in connection with credit claims subject to public law; (4) refinancing agreements gathering specific requirements; and (5) acts or transactions subject to foreign law that are unavoidable under the circumstances.

Should the clawback action be successful, the act or contract will be rescinded. Concerning bilateral contracts, parties shall then return the consideration, having the non-insolvent party right to a pre-deductible claim (or subordinated if found to have acted with bad faith). As to avoided acts and contracts other than bilateral contracts, the creditor gets a claim (e.g., regarding debt-to-asset swaps, the asset must be turned over and creditor gets a reinstated prepetition claim).

In order to avoid clawback risk, out-of-court refinancings and, in particular, the security interests taken can be ‘ring-fenced’ from clawback through homologation and notarisation with certain additional requirements, as explained in the next subsection below.

In addition to the insolvency law clawback action, generally applicable fraudulent conveyance actions, which require intent and have a four-year reach-back period, also work in *concurso*. Pursuant to the Spanish Supreme Court case law, intent is found to concur when a diligent creditor could not ignore that the act or contract at issue was detrimental for the estate or rest of creditors. This general fraudulent conveyance action is the only one applicable to unwind security interests subject to the financial collateral regime.

iv Formal methods to restructure companies in financial difficulties (within insolvency proceedings)

Insolvent companies have the following mechanisms available under the SIA to restructure their debts.

Composition agreements

An insolvent debtor may restructure the company’s debt by entering into composition agreements with its creditors. The SIA distinguishes between two types: (1) early composition agreement; and (2) ordinary composition agreement.

Composition agreements include term extensions (up to 10 years) or haircuts (or both). They may also establish corporate restructurings such as mergers, the sale of assets or business units as a going concern (with the same rules described in Section II.ii), debt-to-asset swaps, conversion into subordinated loans (PPLs) or into any other debt instrument. Other alternatives are also available. These measures other than haircuts and term extension cannot affect public creditors. Moreover, under no circumstance can composition agreements determine the global liquidation of a company. The proposal for a composition agreement shall include a repayment schedule and a business plan (if debtor expects to repay the debt with the ordinary course cash flows).

For voting and recovery purposes, claims are classified into secured, generally privileged (unsecured but with priority in distribution), ordinary unsecured and subordinated. Secured and generally privileged claims are also classified into financial, trade, public and labour. Secured claims are stripped down in accordance with the security interest value (nine-tenths of collateral fair value). The deficiency claim is classified according to general rules.

Concerning voting, there is no cross-class cramdown or absolute priority rule (although this will change with the implementation of the EU Preventing Restructuring Framework Directive). Spanish insolvency law relies on cram-in rules. Moreover, in spite of valuation, subordinated creditors, who have no voting rights, are entitled to the same treatment as ordinary unsecured claims (although deferred – if the composition agreement includes...
debt deferrals, those terms will be counted for subordinated creditors as from the expiry of the forbearance period of ordinary creditors). Finally, yet importantly, there are no equity cramdown mechanisms. The debtor can bargain with the right to petition for liquidation at any point in time (even if the composition agreement proposal comes from creditors and obtains the relevant majority thresholds). The only exception thereof are homologated refinancing agreements with an independent valuation working out the debt-to-equity swap fairness.

Composition agreements with haircuts up to 50 per cent or term extension (or conversion into PPL) up to five years require a majority of 50 per cent of ordinary unsecured claims. This is 60 per cent concerning secured and generally privileged claims. Any other content requires a 65 per cent majority threshold for ordinary unsecured creditors and 75 per cent as for secured and generally privileged creditors. A simple majority is sufficient if there is full payment within no more than three years or immediate payment with a haircut lower than 20 per cent. There is a specific voting rule established for syndicated creditors. The whole syndicate accepts the composition agreement if 75 per cent of participants favour the proposal, unless a lower majority is provided in the syndicated agreement.

**Ordinary composition agreements**

The debtor or creditors may submit ordinary composition agreement proposals with the support of 20 per cent of the claims no later than 40 business days before the creditors’ meeting. Voting may be in writing (if there are over 300 creditors) or at a creditors’ meeting.

**Early (pre-arranged) composition agreements**

Only debtors are entitled to submit early composition agreement proposals at an early stage of the insolvency proceedings and may do so at any time from filing for insolvency, subject to certain restrictions linked to directors’ failure to comply with their management duties. The debtor needs the support of 20 per cent of the claims (or 10 per cent if the proposal is filed with the petition for insolvency).

**Sale of business unit (pre-pack sales)**

The business unit can be sold off at any time during the insolvency proceedings with the authorisation of the insolvency administrator and court approval (usually through auctions, although direct sales are also possible). Moreover, the SIA provides a specific type of accelerated pre-packaged sale when a debtor simultaneously files for insolvency and liquidation with an agreed binding offer.

An important aspect of the sale of business units or pre-packaged sales is that purchaser can assume or reject (without having to pay damages) executory contracts, licences and administrative permits.

The purchaser can also leave behind the debtor’s debts (both insolvency claims and administrative expenses) except for labour claims and social security claims. Cherry picking certain claims (normally for business reasons) is also permitted. Importantly, no taxes or tax contingencies are transferred to the purchaser. In practice, however, the deal structure becomes paramount in order to minimise the accrual of taxes related to the very sale of the business unit.

The business unit can also be transferred free of any liens and security interests (although the purchaser may elect to assume secured financial contracts, in which case the security
interest is not cancelled). The statutory rule is that secured creditors who fail to enforce the security interest ahead of liquidation lose control over the collateral, although they maintain the right to get hold of a part of the price equivalent to the weight of the collateral in the estate. On the other hand, if secured creditors have already initiated enforcement proceedings and the collateral is included in the business unit, they have veto right unless (1) they receive a percentage of the price equivalent to the value of the security interest (nine-tenths of collateral fair value) or (2) 75 per cent of the secured claims from the same class (public, labour, financial or trade) so consent.

v Out-of-court mechanisms to restructure companies in financial difficulties

Out-of-court refinancing agreements

Articles 71 bis (1) and 71 bis (2) regulate, respectively, collective refinancing agreements and non-collective or individual refinancing agreements. Both refinancing agreements and their security interests enjoy immunity to any clawback action, and lenders’ claims will not be equitably subordinated as for old and fresh money given as part of the refinancing.

Collective refinancing agreements are those entered into by debtor and creditors whose claims represent at least 60 per cent of debtor’s liabilities (as evidenced by a certificate issued by debtor’s auditor). Collective refinancing agreements must: (1) be supported by a viability plan allowing the continuity of the business activity in the short and medium term; (2) involve a significant increase of available credit, or the amendment of existing obligations (either through rollover or maturity extension); and (3) be notarised before a Spanish public notary.

Individual refinancing agreements are those available when collective refinancing agreements are not possible. These refinancing agreements shall meet the following requirements: (1) the ratio of assets over liabilities is improved; (2) the resulting amount of current assets is not less than the current liabilities; (3) the value of the security interests (calculated according to SIA criteria) does not exceed nine-tenths of the value of the outstanding debt owed to the creditors participating in the agreement, and does not exceed the previous ratio between security interests and the outstanding debt owed to such creditors; (4) the interest rate of the existing debt or debt resulting from the refinancing agreement does not exceed the interest rate applicable to the previous debt by more than a third; and (5) it is executed as a public deed before a Spanish public notary.

Half of the new money extended as part of an individual or collective refinancing agreement (homologated or not) earns the administrative expense treatment in the event of concurso (the other half enjoys a priority in distribution ahead of ordinary unsecured claims).

Court-sanctioned scheme of arrangement (homologation proceeding)

The fourth additional provision of the SIA regulates homologación judicial (court-sanctioned workouts), which is a proceeding in which a collective refinancing agreement supported by at least 51 per cent of the financial claims (excluding public, labour and trade creditors) is sanctioned or ‘homologated’ ex post by the court to protect it against insolvency clawback actions.

In addition to the protection against the insolvency clawback action and the new money incentive, the most relevant effect of the Spanish scheme is that it allows extension of effects – through a cram-in mechanism – to dissenting and holdout creditors with unsecured and secured financial claims. In this regard, secured claims that exceed the value of its collateral will be treated as unsecured claims for the non-covered portion (the deficiency claim).
the other hand, Spanish law does not foresee any mechanism to cram down equity holders. However, shareholders of the debtors may be personally liable in the event of liquidation when they reject, without a reasonable cause, a debt-to-equity proposal based on a fairness opinion that frustrates a collective refinancing or a court-sanctioned scheme. As far as we are aware, this liability regime, which presents certain technical and practical issues, has not yet been applied in practice.

The majority thresholds to extend the refinancing agreement to holdouts depend on the content and on whether such holdouts’ claims are secured or unsecured.

When dealing with unsecured financial claims: (1) the majority threshold is 60 per cent of the claims to extend term extension up to five years or conversion into profit participating loans with a term up to five years; and (2) a majority threshold of 75 per cent of the claims to extend term from five to 10 years, unlimited haircuts, debt-to-equity swaps, debt-to-asset swaps, conversion into profit participating loans with a term from five to 10 years, and conversion into different financial instruments.

Regarding secured financial claims, a majority of 65 per cent of the secured claims (calculated by value of the security interest as defined by the SIA) is required as for (1) above and 80 per cent of the secured claims in relation to (2) above.

The concept of financial debt has been very controversial. According to recent cases (namely Abengoa), contingent debt that has not yet crystallised should not be affected debt for homologation purposes. In those cases, the only way to refinance dissident contingent debt would be a composition agreement in concurso.

For purposes of calculating such percentages, claims held by specially related parties to the debtor (in general, shareholders over 10 per cent or 5 per cent, directors and other entities part of the same corporate group) are not accounted. There is also a special rule for syndicated instruments, by which where more than 75 per cent of the claims support the refinancing, the whole syndicate is deemed to actually support it.

Holdout creditors may challenge the judge’s homologation ruling based on two limited grounds: (1) existence of disproportionate sacrifice (a concept subject to several constructions by our courts); and (2) failure to meet the majority thresholds. The debtor can only apply for one homologation process per year, although in Abengoa there were two homologations (a standstill and refinancing agreement) on the basis that second one was filed by lenders, which remains controversial.

Out-of-court payment schemes

Dissenting creditors can also be crammed down by means of this straightforward mechanism only applicable to individuals and small companies (companies with less than 50 creditors, estimated liabilities or estimated assets of €5 million or less and for extension of terms up to three years). Both extensions up to 10 years and write-offs are available subject to approval by a 60 to 75 per cent majority of claims. However, debtors have not taken much advantage of it, and it has been rarely used owing to lack of creditors’ support.

vi Taking and enforcement of security

Taking security

Under Spanish law, obligations can be secured by in rem rights (e.g., mortgages over real estate) where a specific asset secures fulfilment of an obligation, or in personam guarantees, where a person guarantees fulfilment of an obligation. There are also material differences in proceedings for their enforcement (as explained below) and their treatment during insolvency
under the SIA where creditors with collateral over specific property or rights (e.g., mortgage or pledge), or equivalent rights (e.g., finance lease agreements) are classified as privileged creditors and are only bound by the composition if they accept it voluntarily or through cram-in mechanisms.

Real estate mortgages cover not only land and buildings built on it, but also automatically proceeds from the insurance policies related to the property, improvement works and natural accretions. Parties may also agree to extend the security interest over movable items located permanently in the mortgaged property for its exploitation, proceeds of the mortgaged property and any outstanding rent. They must be granted by means of a public deed before a public notary and filed at the relevant land registry.

Obligations can also be secured by means of a chattel mortgage. This particular type of mortgage can cover the whole business of the grantor (including leases, fixed installations, equipment, intellectual and industrial property, and raw materials and finished goods, if certain requirements are met), motor vehicles and aircraft. Industrial machinery and IP rights can also have their own separate type of security. These mortgages must be executed by means of a public deed before a public notary and entered on the chattel registry.

Since March 2016, aircraft equipment can also be subject to ‘international interest’ under the Cape Town Convention on International Interests in Mobile Equipment. The only requirements are to be set out in writing (identifying the object and the guaranteed obligations) and the guarantor’s title to dispose of them. Entry on the International Registry of Guarantees is a requisite for enforceability against third parties. International interests have priority over any state security regulated by domestic law, even where the state security was created before, and are enforceable in insolvency proceedings if they were registered before the proceedings began (the international interest would be treated in the insolvency as a national in rem security).

For movable assets that cannot be the object of a chattel mortgage (because their specific identity cannot be registered), or of an ordinary pledge (given the legal or financial impossibility being transferred), Spanish law regulates the non-possessory pledge. Movable assets that may be involved in this sort of pledge are raw materials and stock, and machinery. Claims not represented by securities or considered financial collateral (under the Collateral Directive and its transposition under Spanish law) can also be used in a non-possessory pledge. The law requires entry on the Chattel Registry as a condition for validly creating the pledge.

Pledges can also be granted with transfer of possession to the creditor or a designated third party. For the pledge to be enforceable against third parties, a notarised agreement or a public deed must be created. The most common type of ordinary pledge is given over shares and credit rights (such as bank accounts, receivables and insurance policies).

In Spain, a personal guarantee may be granted by means of a fianza (an ancillary guarantee) or by means of a aval or garantía a primera demanda o a primer requerimiento (a first-on demand independent guarantee). The aim of a first demand guarantee is to provide the beneficiary with faster and summary means of enforcement, avoiding unnecessary costs and delays derived from certain benefits and privileges conferred by Spanish law to any guarantor under an ordinary guarantee (i.e., exhaustion of remedies against debtor, division between several guarantors or main debtor and guarantor and requesting payment only after seeking first from the main debtor). In terms of enforceability of first demand guarantees, the court should not analyse the guaranteed obligation, since the first demand guarantee is an abstract, independent and autonomous obligation with respect to the loan agreement.
The most common types of security given in Spanish practice are personal guarantees and pledges over assets (i.e., shares) and claims, since they are not subject to registration (and, therefore, not subject to registration fees or taxation). Stamp duty can be triggered when granting or assigning security if granted by means of a public deed and subject to public registration.

Property mortgages are also a very usual security when the value of the property justifies the payment of the stamp duty and other related costs. More recently, floating mortgages (Article 153 bis) are popular since they can secure several financial obligations and, consequently, prove cost efficient, but are only available to credit institutions. Other securities also subject to registration (such as mortgages over machinery or trademarks and pledges without transfer of possession over stock or raw materials) are less common because of the stamp duty and costs involved.

Lastly, some Spanish autonomous regions, particularly, Catalonia, have approved regulation on security interests that differs significantly from Spanish common law.

**Enforcing security**

Under Spanish law, mortgages and pledges can be enforced in judicial or notarial proceedings. In judicial proceedings, the asset can be realised by direct sale, by a specialist entity or through an auction. Notarial proceedings can only be carried out by auction. In both proceedings, auctions must be carried out through an electronic auction held on the Official Gazette of the Spanish state’s auctions portal. Pledges over credit rights are usually enforced by offsetting or direct transfer. Direct sales are still controversial, but should be fine if executed at fair value and including escrow mechanisms for junior creditors.

Personal guarantees can be enforced either through *procedimiento declarativo* (declaratory civil proceedings) or *procedimiento ejecutivo* (summary executive proceedings), the latter when certain conditions are met (granted by means of a public deed where the secured obligation is clearly specified). Summary executive proceedings are faster and more effective, while the declaratory civil proceedings are more time-consuming.

At pre-insolvency stages, the SIA limits the possibilities of enforcing collateral required for the continuity of debtor’s professional or business activity. In addition to the 5 bis notice (see Section II.ii), upon insolvency declaration, enforcement may not commence until a composition is approved (which does not affect that entitlement) or one year elapses without composition or liquidation. For this purpose, the law extends the treatment to the recovery of movable property sold by instalments and those assigned by financial leases, as well as to the cancellation of real estate sales owing to failure on payment of the deferred price.

**vii Duties of directors and liabilities; guilty insolvencies**

Under Spanish law, there is no shift of directors’ fiduciary duties to creditors when approaching or during insolvency. Having said that, when a company is in financial distress, directors may be found liable in certain specific cases.

Spanish companies’ directors must perform their duties with the diligence of a careful entrepreneur and loyal representative. In a financially distressed scenario, that means they can be jointly and severally liable for corporate debts if they breach their duties relating to winding up the company. If losses reduce equity to less than half of share capital, directors must call a general meeting within two months to pass the resolution to wind up the company or, if the company is insolvent, to petition for insolvency proceedings.
The two-month term for calling a general meeting runs from the date the directors became aware or should have become aware of the cause for winding up with the diligence required from them. If the general meeting fails to do so, the directors have a duty to apply for a court-ordered winding up of the company.

Breaching these obligations is enough to incur directors’ liability, regardless of any damage to creditors, directors’ culpability or a causal link. Consequently, a creditor may claim the full amount of the debt from any director if accrued after the onset of the capital imbalance scenario.

In insolvency situations, the directors’ liability regime is only triggered when it is necessary to categorise the insolvency (i.e. when the liquidation phase starts or in some cases when a composition agreement is reached) either as fortuitous or culpable. Insolvency is categorised as guilty when the insolvency situation is created or aggravated by the willful misconduct or gross negligence of the formal or de facto directors, general proxy holders or any person who had that status within the two years before the insolvency declaration.

The SIA provides for certain iuris et de iure (no contrary evidence is admitted) assumptions of guilty insolvency (e.g., the material breach of accounting duties) and iuris tantum (unless proved otherwise) assumptions of culpable insolvency (e.g., breaching the duty to timely petition insolvency declaration).

Directors in a guilty insolvency can be disqualified from managing third-party assets for a term of two to 15 years and can lose any right as creditors in the insolvency and indemnity for the damage caused. Additionally, in the event of liquidation, when the insolvency estate is insufficient to cover the claims, the court may order directors declared affected by the categorisation to cover all or part of the deficit.

III RECENT LEGAL DEVELOPMENTS

Although not constituting case law since homologation rulings are not appealable, the Seville Commercial Court No. 2 of Seville, of 25 September 2017, entails a significant court development in terms of objections and challenges to homologation.

First, in contrast to the FCC ruling, and concurring with Bodybell, the court found that syndicate dissidents (five groups of bondholders) do have standing to object to homologation. In addition, trade creditors who are aware of their claims being affected by the restructuring also have standing to object to homologation based on the commercial character of their claims (the Eroski case had particularly cast doubt on this). Otherwise, commercial creditors may eventually seek relief before general jurisdiction courts.

Second, in contrast to the FCC criterion, the judge sustained that the majorities must be determined as per the total financial debt and not as far as the affected debt only. The 75 per cent threshold calculation base includes: (1) financial claims outside the refinancing debt scope; (2) non-compromised debt, such as interim new money financing; and (3) secured debt, irrespective of whether or not the effects are extended to dissident secured claims – which may be analysed under the disproportionate sacrifice exception.

Third, the court confirmed that contingent claims are not financial claims for homologation purposes. Contingency disappears with technical default occurrence. Whether financial statements are correctly elaborated (and whether or not a guarantee was registered as a liability, a provision, or not even accounted for in the balance sheet) is not a critical argument to consider that a liability is or is not a financial claim, despite the consequences of any potential flaws as a matter of corporate law and, potentially, directors’ liability. This criterion has recently been controverted in other courts.
Fourth, the court concluded that the arguments below may be embedded within the disproportionate sacrifice exception (which permits dissidents to be left off the hook, but does not entail the workout unwinding unless to specifically provided in the refinancing agreement):

a  the sacrifice is unnecessary because (1) the restructuring is unfeasible — on the other hand, holdouts cannot object to homologation based on the absence of a business plan or seek unwinding thereof based on plan unfeasibility; or (2) the workout content exceeds the real needs under the business plan; and

b  the sacrifice is unfair: (1) in light of the liquidation test; (2) because the dissident is treated less favourably than acceded creditors without sufficient reason or consideration; (3) because holdout receives worse treatment than other creditors with the same priority in distribution in bankruptcy; (4) because creditors who would be junior in bankruptcy are treated equally or better than holdout; or (5) because the better treatment obtained by senior creditors is unreasonable in light of the difference as to the bankruptcy priorities in distribution.

Fifth, the court sustained the existence of disproportionate sacrifice based on different treatment conferred to supporting and dissident lenders in terms of haircuts, term extensions and interests. Holdouts should have given the option to choose after homologation, similar to the acceded lenders.

Certain other relevant points in this ruling are the following:

a  As for the allegation that the security interests in favour of the new money were disproportionate, the court found that this is not a valid ground to object to homologation. Besides, the homologation ring-fence protection does not impede challenges based on generally applicable fraudulent conveyance law.

b  The court also rejected the absolute priority rule allegation, because (1) Spanish insolvency law only establishes two classes as per homologation: secured and unsecured financial claims; and (2) apart from the fact that the draft EU Directive absolute priority rule is not yet in force, it could not be applicable in homologation, since, strictly speaking, no class is imposing a plan over other dissident classes.

c  The court held that (non-enforced) bonding lines, corporate guarantees and insurance are financial claims, despite the underlying obligation being a commercial or trade claim. On the other hand, enforcement leads to the settling guarantor or insurer stepping in the shoes of the trade creditor. Hence enforced corporate guarantees, insurance and bonding lines would not be financial claims and would, therefore, be unaffected by homologation.

d  The court sustained that the public claims safe harbour is only applicable to European administrations and agencies.

e  Irrespective of whether the workout is extended to dissident holders of secured claims, the court insisted on its view that the petitioner must produce the security interests valuation report. The court rejected Abengoa’s and supporting lenders’ allegation that this was not required as, following the enforcement of the security interest, the deficiency claim would have always been subject to the alternative restructuring terms (i.e., to the refinancing agreement).
IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

The crisis in Spain has affected severely all sectors. However, the construction companies, real estate developers, retailers, manufacturers and some financial institutions are the ones that suffered from this the most. Even at this economic stage, Abengoa and Toys ‘R’ Us are both good examples.

i Toys ‘R’ Us Iberia: sale and new facility

As a result of the Toys ‘R’ Us group's financial troubles worldwide, its companies in Iberia took joint and several liability for global liabilities worth almost US$900 million. In addition, due to the insolvency of several of the group’s companies and the risk of enforcement of the security against the assets in Spain, the group filed for bankruptcy for three of its Spanish companies in March and April 2018: the two shareholding companies of the company operating in Spain and the company owning the real estate. The restructuring solution consisted of an agreement with the main creditors, allowing an investor to step in with sufficient resources to ensure the group's future viability in Spain and Portugal.

The transaction was authorised by Commercial Court No. 7 of Madrid in an order issued on 26 July 2018, which considered the interest of all the group's companies – not just the interest of the company that provided the security in the transaction – and analysed the transaction’s countervailing benefits (reduction of liabilities, business continuity, overcoming insolvency) as opposed to an alternative scenario (bankruptcy of the whole group in Spain and Portugal).

The procedure ended in August 2018 with the (1) execution of a sale agreement for the shares of the group's parent company in Iberia by Portuguese investment group Green Swan, and (2) granting a facility of €59 million by Incus Capital. Thanks to this financing, Toys ‘R’ Us has managed to cancel all its debt with international creditors, to overcome insolvency and to obtain funds to finance the continuity of its activity in the Iberian market.

ii Abengoa: 2019 restructuring

The 2019 restructuring process of Abengoa’s group has been one of the Spanish largest restructuring in 2019 (with a debt of approximately €3 billion) and had worldwide impact, due to the size and international presence of the group. The restructuring process began on September 2018, when the company and its financial creditors set out the main terms and conditions for the refinancing of its debt and continued in December 2018, when the debtor and its financial creditors entered into a lock-up agreement. The restructuring process was completed with the execution of the restructuring agreement in March 2019 and the subsequent effectiveness of the restructuring documents taking place in April 2019.

The restructuring agreement of the engineering and renewable energy group resulted in, among others, (1) a €97 million new money injection arising from the issuance of convertible bonds by A3T LuxCo 2; (2) a €140 million injection in favour of Abenewco 1 by means of a new syndicated guarantee line and the amendment of the terms of the 2017 existing syndicated guarantee line; (3) the restructuring of the NM2 debt, including a partial debt assumption by A3T Luxco 2 of the 45 per cent NM2 debt that was sitting in Abenewco 1; (4) the recognition by Abenewco 1 in favour of certain financial creditors, of a restructuring commission by means of a new reinstated debt facility agreement; (5) the recognition by Abenewco 1 in favour of certain financial creditors, of a restructuring commission by means
of the issuance of mandatory convertible bonds, for a nominal of approximately €5 million, which would entitle them upon conversion to 22.5 per cent of Abenewco 1’s share capital; (6) the restructuring of the restructuring of the old debt (that accrued or that stemmed from contracts entered into prior to the first restructuring); and (7) the amendment of the 2017 intercreditor agreement and security package.

On May 2019, Abengoa filed for the homologation of the 2019 restructuring agreement. The 100 per cent of the financial debt adhered to the 2019 restructuring agreement and therefore, no dissenting creditors need to be crammed down.

V INTERNATIONAL

The new European Regulation on insolvency proceedings (EU Regulation 2015/848, recasting EU Regulation 1346/2000) entered into force on 26 May 2017. One of the goals of EU Regulation 2015/848 is the inclusion in Annex A of all new restructuring proceedings (alternative to full-blown insolvency proceedings) enacted across the EU. In the case of Spain, Article 5bis notices, homologation and out-of-court payment schemes are now automatically recognised in the EU.

Concerning reorganisation of companies with their COMI in Spain and multi-jurisdictional debt instruments, we expect homologation to remain the restructuring means chosen to deal with these cross-border cases. Homologation passed muster for the Chapter 15 recognition test in both the Abengoa and Isolux cases. Most importantly, absent a COMI-shift, other alternatives (such as Chapter 11 and scheme of arrangements) present significant issues when it comes to cramming down dissenters with recourse to assets located in Spain. First, Spanish courts shall not recognise foreign main proceedings where the jurisdiction is not based on COMI location or similar criterion. Second, any creditor would always be entitled to seek a non-main proceeding in Spain, undermining the benefits of a global and comprehensive reorganisation. Third, in the absence of a non-main insolvency proceeding in Spain, secured creditors with collateral located in Spain would be able to bypass the main insolvency proceeding automatic stay and be instead subject to the Spanish insolvency law automatic stay.

Finally, yet importantly, concerning clawback risk, Spanish courts shall provide protection to creditors, purchasers and other third parties under contracts subject to non-Spanish law, according to which the contract or act at hand would be unavoidable under the circumstances (see, recently, the ruling from Palma de Mallorca Court of Appeals of 17 October 2017 – Orizonia case). Within the EU territory, the ECJ ruling of 8 June 2017 (Vinyls Italia SpA, C-54/16) has confirmed the ability of the parties to have a contract governed by foreign law even where all the links are tied to the same country (Italy), absent fraud, which must be determined by the insolvency court.

VI FUTURE DEVELOPMENTS

Although no comprehensive insolvency law reform is currently pending, we expect reforms revising the current structure and drafting (proposal presented by a group of experts on 6 March 2017), without meaningful changes, and reinforcing the role of the homologation proceeding based on Directive on preventative restructuring frameworks, ‘second chance’ and measures to increase the efficiency of restructuring, insolvency and discharge procedures.
Chapter 20

SWITZERLAND

Daniel Hayek and Mark Meili

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

Switzerland’s GDP rose by 0.6 per cent in the first quarter of 2019. Positive impulses came from most sectors, in particular domestic demand and foreign trade. The Swiss federal government’s Expert Group in spring 2019 expected the GDP to grow by 1.1 per cent in 2019, down from previous expectations of 1.5 per cent, mainly because the global economy has lost more momentum than previously assumed. The hitherto favourable economic environment has had a positive impact on the labour market, with unemployment gradually declining since mid-2016. In April 2019, the unemployment rate was at 2.4 per cent, decreasing from 2.7 per cent in April 2018. However, the Expert Group is predicting a slight increase in unemployment in the further course of the year as a result of the economic slowdown.

As a result of poor growth and inflation prospects abroad, the Swiss National Bank (SNB) has revised its inflation forecast downwards and anticipates an inflation rate of 0.3 per cent for 2019. For 2020 and 2021, the SNB predicts inflation of 0.6 per cent and 1.2 per cent, respectively.

In Switzerland, no official statistics are published with regard to ‘composition proceedings’, that is, formal restructuring proceedings. With regard to bankruptcy proceedings, in 2018, 15,291 bankruptcy proceedings were opened, which equals a slight increase of 0.15 per cent compared to 2017. Although this is an all-time high number, losses resulting from bankruptcy proceedings have generally been decreasing since 2015, and sharply decreased by 20.6 per cent compared to 2016, equalling losses of 2 billion Swiss francs.

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II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

Switzerland does not have a comprehensive law on insolvency and restructuring procedures. While insolvency matters are mainly governed by the Swiss Debt Enforcement and Bankruptcy Law (DEBL), formal restructuring procedures are provided for in both the DEBL and the Swiss Code of Obligations (CO), with the latter also containing provisions on informal restructuring methods.6

i Informal restructuring techniques

Normally, a company in financial difficulties will first try to improve its situation through informal restructuring, avoiding the involvement of courts unless inevitable. Operational restructuring measures may include changes in management or the disposal of underperforming businesses. Other informal restructuring techniques are provided for by company law. The CO allows for the revaluation of immovable property and participations at their real value (as compared to the purchase value at which they are usually evaluated) if half of the company’s equity and its legal reserves are no longer covered by its assets. Further, a company can gain capital through issuing new shares for consideration and thereby improving its debt-to-equity ratio. Another measure often used is the reduction, possibly to zero, of the share capital, followed by an immediate share capital increase.

Some creditors may have a special interest in the distressed company’s survival, for instance as shareholders of that company or if they are part of the same group of companies, and in one way or another contribute to its restructuring. This could be through the granting of a bridge loan until the company secures permanent financing or through waiving part or all of their claims. A creditor may also agree to subordinate instead of waving their claims. This is a technique often used, as Article 725 II CO allows postponing the notification of a judge in case of over-indebtedness, if claims in the amount of the capital deficit are subordinated to all other liabilities (i.e., generally subordinated). Although a subordination agreement itself does not constitute restructuring measures, as the financial situation of the company remains unchanged, it increases the chances for a distressed company to financially recover as it allows for more time to adopt restructuring measures.

ii Formal procedures

The two main types of formal restructuring and insolvency proceedings provided for in the DEBL are bankruptcy and composition proceedings.7 Unlike bankruptcy, composition proceedings do not necessarily lead to the dissolution of the company. In addition, the CO provides for a ‘corporate law moratorium’.

Bankruptcy proceedings

A company is placed into bankruptcy by the competent court upon request of either a creditor or the debtor itself. In addition, bankruptcy proceedings can be opened over a company ex officio, for example, because of serious organisational deficiencies. A creditor may file a

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6 A number of laws and ordinances other than the DEBL contain additional provisions on insolvency, providing special insolvency regimes for certain types of debtors, namely financial institutions, collective investment schemes or insurance companies.

7 This chapter will only describe insolvency proceedings applicable to companies.
request for bankruptcy if its claim has not been settled by the debtor although it was upheld in debt-collection proceedings. Further, a creditor may request the court to open bankruptcy proceedings without prior debt collection proceedings, if other reasons justify the immediate opening of bankruptcy proceedings, such as fraudulent behaviour or cessation of payments by the debtor. Finally, the debtor itself can request the opening of bankruptcy proceedings by declaring its insolvency – the board of directors even has a legal obligation to do so if the balance sheet shows that the company is over-indebted.

The DEBL provides for two types of bankruptcy proceedings. Summary proceedings are commenced if the proceeds from the assets are unlikely to even cover the costs of the bankruptcy proceedings or if the case is of a simple nature. They generally do not entail creditors’ meetings or a creditors’ committee. In all other cases, ordinary proceedings apply.

Once a debtor is declared bankrupt by the competent court, it loses the right to dispose over its assets, despite remaining the beneficial owner of its estate. The right is transferred to the bankruptcy estate, which is represented exclusively by the bankruptcy administration. The objective of the bankruptcy proceedings is the full liquidation of the debtor’s estate, including all assets and liabilities, to satisfy all creditors in proportion to their claims against the debtor. All creditors participate in the bankruptcy proceedings, which means that all debt enforcement proceedings initiated before the declaration of bankruptcy come to an end and that no new debt enforcement proceedings against the debtor can be initiated by creditors on an individual basis. The bankruptcy administration publishes a notice inviting creditors to the first creditors’ meeting and summoning them to file their claims and debts within one month and to hand over any collateral.

The first creditors’ meeting is entrusted with appointing either the public bankruptcy office or a private bankruptcy administrator as well as electing a creditors’ committee, which is generally in charge of supervising the bankruptcy administration. It further decides on administrative actions, such as the continuation of the debtor’s business activities. The bankruptcy administrator decides on the filed claims in the schedule of claims, which can be contested by the creditors before the competent court. The second creditors’ meeting is convened to decide on matters such as the continuation of claims against third parties and the realisation of the debtor’s assets (by way of public auction, private sale or assignment to a creditor).

The proceeds are used to satisfy the creditors’ claims in accordance with their rank. Secured creditors are satisfied before all other claims out of the proceeds from the sale of the collateral. Unsecured creditors are divided into three classes. The first class of claims mainly consists of claims arising from employment relationships with the debtor, accrued within six months prior to the opening of the bankruptcy proceedings. The second class encompasses claims from social security, health and unemployment institutions. The third class comprises all other unsecured and unsubordinated claims, accrued before the opening of the bankruptcy proceedings. Dividend distributions are made according to the creditors’ ranking. The creditors in a lower class will only be satisfied if and to the extent the creditors of the higher ranking class have been satisfied in full. If the insolvency estate does not have enough funds to cover all claims in one class, the proceeds are distributed to the creditors of that class on a pro rata basis according to the claim amounts.

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Note that estate claims that consist of claims arising out of transactions entered into after the opening of insolvency proceedings as well as the costs of conducting the proceedings, are satisfied with priority before any distributions are made to other creditors.
After distribution of the bankruptcy estate among the creditors, the bankruptcy administration submits its final report to the bankruptcy court, which declares the proceedings closed, if it finds that the bankruptcy proceedings have been fully completed.

**Composition proceedings**

Composition proceedings aim to protect a debtor from bankruptcy proceedings and alleviate financial distress. They are usually initiated by the debtor itself by supplying the court with financial statements and a restructuring plan. Composition proceedings may also be requested in ongoing bankruptcy proceedings by the debtor and a creditor. If a successful conclusion of a composition agreement seems possible, the bankruptcy court may even transfer the matter to the composition court *ex officio*.

The composition court will grant a provisional debt moratorium, pursuant to Article 293a et seq. DEBL, and order measures to preserve the debtor’s assets and appoint an administrator to assess the chances of restructuring and reaching a composition agreement with the creditors. If a successful restructuring or reaching a composition agreement seem likely, the composition court grants a definitive debt moratorium of up to 24 months, pursuant to Article 294 et seq. DEBL. In the opposite case, bankruptcy proceedings will be opened *ex officio*. During the (provisional or definitive) debt moratorium, the debtor is protected from further financial distress, insofar as no debt enforcement proceedings can be commenced against the debtor. Unlike in bankruptcy proceedings, the debtor may continue running its business, although under the supervision of a court appointed administrator. The latter may be required to approve certain transactions, such as the termination of contracts whose continuation would jeopardise the successful restructuring of the debtor. The disposal of fixed assets may require the approval of the composition judge or the creditors’ committee, respectively.

The court-appointed administrator also supports the debtor in trying to reach a composition agreement with the creditors, who are summoned to file their claims just like in bankruptcy proceedings. There are two types of judicial composition agreements. The ordinary composition agreement pursuant to Article 314 et seq. DEBL allows for the restructuring of the debtor either through a moratorium agreement providing for full payment of creditors’ claims at a later stage or a dividend agreement, whereby the claims are partially waived. In a composition agreement with assignment of assets pursuant to Article 317 et seq. DEBL, the debtor assigns its assets to the creditors for realisation by a liquidator who then satisfies the creditors’ claims out of the proceeds. Although an assignment of only parts of the assets is possible, usually the agreement will assign all assets and thus lead to the liquidation of the debtor company. From this point on, the proceedings do not aim at restructuring the company but at achieving the highest possible recovery rate for creditors. Despite being similar to bankruptcy proceedings, composition proceedings allow for more flexibility in the realisation of assets, which is why they may be given preference over bankruptcy if parts of the company can be sold without loss of value. In fact, almost all of the largest insolvency cases in recent years have been settled through composition proceedings.

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9 Creditors entitled to request the opening of bankruptcy proceedings, can also request composition proceedings under the same conditions.

10 Article 297a DEBL.

11 See Article 256 Paragraph 3 DEBL and Article 322 DEBL.

12 Notable examples of composition proceedings with assignment of assets are SAirGroup AG, Swissair Schweizerische Luftverkehr AG, Petroplus Marketing AG and Unifina Holding AG.
A composition agreement requires approval by a majority of the creditors and the composition court. Once approved, the composition agreement will be binding on any creditor whose claims either arose before the moratorium or have since come into existence without approval by the administrator. The agreement is not binding on secured creditors to the extent that their claims are covered by the collateral. If the composition agreement is rejected, the composition court will open bankruptcy proceedings *ex officio*.

Composition proceedings may also result in an extrajudicial composition agreement. In addition, they may end without the need to reach any composition agreement at all if the debtor can be successfully restructured during the moratorium.

**Corporate law moratorium**

The corporate law moratorium is provided for in Article 725a CO, which aims to enable a distressed debtor to restructure. As explained below in more detail, the board of directors of a company is legally obliged to file for bankruptcy if the company is over-indebted. Upon application of the board of directors or a creditor, the court may grant a stay of bankruptcy proceedings. A stay is granted if there is a prospect of financial restructuring, which will usually be the case if the court has been submitted a realistic restructuring plan by the board of directors. In such cases, the court will render measures to preserve the debtor’s assets. In particular, the court may appoint an administrator and define his or her duties. Since publication of the corporate law moratorium will usually have a negative effect on a company’s business relationships and hence its restructuring efforts, the law allows for the non-publication of the stay of bankruptcy proceedings, unless this is necessary to protect third parties. The effects of the corporate law moratorium are not as far-reaching as those of a debt moratorium in composition proceedings: although a creditors’ requests for opening of bankruptcy proceedings or for liquidation of the debtor’s assets may not be granted during the moratorium, creditors can still commence debt enforcement proceedings against the debtor.

### Selected topics

**Taking and enforcement of securities**

There are several forms of security over assets in Switzerland. The most common ones are pledges, including both regular pledges and ‘irregular pledges’, which are not regulated by law. While a regular pledge does not entail a transfer of ownership but rather the mere possession of the collateral, the secured creditor under an irregular pledge not only becomes the possessor but also the legal owner of the collateral, which consists of money, claims or other chattels. Upon satisfaction of his or her claim, the owner has an obligation to return the collateral to the debtor in the same amount and quality. Often, the collateral is also transferred (if it is a non-fungible movable asset or real estate) or assigned (if it is a claim) by way of security. The impact of insolvency on such security rights depends on the type of security arrangement and the type of assets serving as collateral.

Pledged assets form part of the bankruptcy estate, unless the collateral is not owned by the debtor but by a third party. If movable assets (as well as claims or other rights) have been pledged, the secured creditor is not allowed to privately sell the collateral but has to hand it over to the bankruptcy administration for liquidation with the other assets. The DEBL

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13 The composition court will only give approval under certain conditions, namely if the debtor’s offer is reasonable compared to its financial capacities and the privileged creditors’ claims are fully covered.
still guarantees the secured creditors’ right to preferential satisfaction as the proceeds from the sale of the pledged assets will be used to satisfy the secured creditors in priority of all other creditors.\textsuperscript{14} Should the proceeds from the sale of the collateral not be sufficient to fully discharge the secured claim, the remaining amount ranks as unsecured and unprivileged claim.

If real estate has been pledged, the effect of the opening of bankruptcy proceedings on such security depends on the maturity of the secured debt. Unlike all other claims, claims secured by real estate do not automatically fall due with the opening of bankruptcy proceedings.\textsuperscript{15} If the secured debt is due, the real estate will be realised by the bankruptcy administration and the proceeds will be used to satisfy the secured creditors. If the secured debt is not due, the real estate will also be realised by the bankruptcy administrator. The secured creditor will, however, not be satisfied. Instead, the debts will be transferred to the acquirer of the real estate and the pledge will remain in place.

If the security arrangement includes a transfer of ownership under an irregular pledge or if the claims have been assigned or other assets transferred by way of security, such assets do not form part of the bankruptcy estate. The secured creditor is not required to hand the collateral over to the bankruptcy administrator and can, if permitted by the security agreement, liquidate the collateral privately.

In composition proceedings, there is no obligation for creditors with a pledge on movable assets to hand in the collateral to the liquidator. During the moratorium, secured creditors are generally not allowed to commence or continue enforcement proceedings, unless the collateral consists of real estate. The liquidation of real estate is also excluded during the moratorium.\textsuperscript{16} If the proceedings result in a composition agreement, the agreement will not be binding on secured creditors to the extent of the claim covered by the collateral. After the moratorium is lifted, secured creditors can choose between commencing enforcement proceedings and liquidating the collateral privately, in accordance with the pledge agreement.

\textit{Duties of directors of companies in financial difficulties}

Under Swiss corporate law, the board of directors has a general duty to safeguard the interests of the company, which includes the responsibility to ensure that the company remain financially sound and to take the appropriate measures to restructure the company should it be in financial difficulties. Further, depending on the balance sheet situation of the company the law requires the board of directors to take specific measures. The type of measures to be taken by the board of directors depend on the level of losses the company has incurred. A distinction is made between a situation of (1) ‘loss of capital’ (half of the company’s equity is no longer covered by its assets) and (2) ‘overindebtedness’ or negative equity (the liabilities of the company exceed its assets).

If there is a loss of capital, the board of directors immediately has to summon a shareholders’ meeting to inform shareholders about the financial state of the company and suggest restructuring measures for them to decide on.\textsuperscript{17} If there is a substantiated concern that the company might be over-indebted, the board of directors needs to have an interim balance sheet prepared and submitted to the auditors. If the interim balance sheet confirms that the liabilities of the company are neither covered on a going concern nor on a liquidation

\textsuperscript{14} Article 219 Paragraph 1 DEBL.
\textsuperscript{15} Article 208 Paragraph 1 DEBL.
\textsuperscript{16} Article 297 Paragraph 1 DEBL.
\textsuperscript{17} Article 725 II CO.
scenario basis, the board of directors has to notify the judge, a duty which the board cannot delegate. Such notification will usually lead to the opening of bankruptcy proceedings. Notification can only be avoided, if some creditors of the company agree to subdivide their claims behind those of all other creditors to an extent sufficient to compensate the negative equity as described above. Further, the Swiss Federal Supreme Court held that the board of directors may abstain from notifying the court, if immediate restructuring measures are available. The chances of restructuring must be tangible and delaying the notification of the court may not endanger the financial situation of company creditors.

Taking timely action as described is a key component of the directors’ duty to perform their tasks with due care. If they fail to do so, they risk becoming personally liable under Article 754 CO to anyone suffering losses (i.e., the company, shareholders and creditors), if an intentional or negligent breach of their duty of due care can be established. The relevant damage consists of the increase in the company’s losses occurring between the point in time, in which the board learned about the situation of over-indebtedness (and failed to notify the bankruptcy judge) and the date on which the company is declared bankrupt. In a series of decisions, the Swiss Federal Court held that subordinated debts should be included in the calculation of the damage caused to a company in a director’s liability claim as subordination does not constitute a waiver and thus not diminish the company’s damage. This approach increases the liability exposure of directors, who try to keep the company alive by using the possibility of subordination rather than immediately filing for bankruptcy. The decisions have thus been subjects to criticism, arguing that company law encourages subordination as a last attempt to save the company and that the use of this instrument should not negatively affect directors, if the company subsequently has to file for bankruptcy.

**Clawback actions**

To ensure that all creditors are treated equally, the DEBL provides for a number of clawback actions. Assets, which the debtor has disposed of before becoming insolvent can be returned to the insolvency estate under certain conditions. Transactions entered into by the debtor may be challenged if the transaction was disadvantageous for the creditors. Only those transactions, for which the debtor did not receive appropriate consideration, are voidable and only upon the condition that the insolvency estate’s assets are not sufficient to cover all claims. The contestability of such transactions is limited in two respects. On the one hand, they must have been concluded in a determined period of time prior to the opening of bankruptcy proceedings or the approval of a composition agreement with assignment of assets (suspect period). The length of the suspect period depends on the nature of the transaction challenged. On the other, the DEBL exhaustively enumerates the revocable pre-insolvency transactions.

Gifts and other transactions free of charge or made without adequate consideration, which were entered into by the debtor within the year prior to the opening of bankruptcy proceedings or the grant of a moratorium in the case of a composition agreement with

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18 Article 716a I CO.
19 Article 725 II CO.
20 Decision of the Swiss Federal Supreme Court of 2 October 1990, BGE 116 II 533.
22 Article 725 Paragraph 2 SCO.
The adequacy of the consideration is assessed objectively — the parties’ intentions or their good faith are irrelevant. It is further irrelevant whether the parties were aware of the discrepancy between performance and consideration. The burden of proof for the inadequacy of the consideration generally lies with the party challenging, with an important exception: if the transaction favoured a related party, which includes companies belonging to the same group, the latter bears the burden of proof.

Certain legal acts, by which some creditors are favoured over others, are voidable if they were made when the debtor was already over-indebted (i.e., the liabilities exceeded the assets). Such acts must have been carried out within a suspect period of one year. They include the granting of security for obligations which did not have to be secured, the payment of claims by unusual means or the payment of debts before they were due. If the counterparty can prove that it was not, and did not need to be, aware of the state of over-indebtedness of the debtor, the relevant transaction cannot be voided.

Finally, the law provides for the general revocability of any act performed with the intention of the debtor of generally harming their creditors or favouring certain creditors to the detriment of the others. In contrast to the other grounds for voidability, the suspect period of time is five years. Article 288 DEBL accounts for its wide application by establishing strict requirements, making it hard for claimants to prevail on these grounds, as not only the intent of the debtor needs to be proven but also that such intent was recognisable for the recipient. If the latter is a related party the burden of proof is reversed (i.e., the recipient will have to prove that the intent of the debtor was not recognisable for them).

A clawback action may be brought by the bankruptcy administration, a composition liquidator or a creditor within two years of the opening of bankruptcy proceedings or the court approval of the composition agreement with assignment of assets. If successful, the recipient has to return the assets to the insolvency estate or, should this not be possible, compensate the estate in cash. In turn, the recipient can claim back his or her own performance given in consideration of the revoked assets.

III RECENT LEGAL DEVELOPMENTS

Since its partial revision, which entered into force on 1 January 2014, the DEBL has not undergone any significant modification. The 2014 revision was adopted as a reaction to the insolvency of Switzerland’s national airline Swissair, which exposed the shortcomings of Switzerland’s restructuring scheme. Its primary objective was to promote restructuring over liquidation in the context of composition proceedings through various amendments, which were discussed in earlier editions of this Review.

In addition, for some years a revision of Swiss company law has been underway, which aims at promoting restructuring of a distressed company, mainly by introducing certain additional obligations of directors in the context of its duties under Articles 725 et seq. CO. The proposal introduces an early warning system, according to which the board of directors would be required to take measures, such as adopting a cash flow forecast for the next six or twelve (for companies subject to ordinary audit) months, if there are signs that the company might be in financial difficulties. Furthermore, the Federal Council suggested deleting the
corporate law moratorium’ from the corporate law sections in the CO and integrating certain of its advantages into the composition proceedings. The Federal Council adopted the related dispatch at its meeting on 23 November 2016, but it remains uncertain, if and when this revision will come into force.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

There are no official statistics in Switzerland on distressed industries. A private study found that in 2018 most bankruptcies were opened over businesses in the construction, tourism and craft sector. Despite the increased number of bankruptcy proceedings, no new landmark (bankruptcy or restructuring) proceedings were opened in the last 12 months of which we are aware. The most high-profile cases, which are still ongoing, include the Swissair insolvency proceedings (i.e., Flightlease AG, SAirLines AG and Swissair AG), the liquidation of the Petroplus group, which operated oil refineries in several European countries (including the liquidation of its holding company Petroplus Holding AG and the main operating company Petroplus Marketing AG, both domiciled in Zug), the insolvency proceedings of companies of the Erb group, of the Banque Privée Espírito Santo SA, as well as the bankruptcy proceedings of the Swiss Lehman Brothers entity.26

V INTERNATIONAL

Since the Council Regulation (EC) No. 2015/848 of 20 May 2015 does not apply to Swiss insolvency proceedings and Switzerland has not adopted the UNICCTRAL Model Law on Cross-Border Insolvency, the recognition and enforcement of foreign insolvency proceedings is dealt with in the Swiss Private International Law Act (PILA).27

A foreign insolvency administrator has no power to act in Switzerland. As a consequence, the administrator cannot directly recover assets located in Switzerland, since they do not have standing in Swiss proceedings and are not allowed to file a claim in the insolvency proceedings of a Swiss debtor of the foreign estate (the latter being a usual scenario where an international group of companies becomes insolvent). In order to safeguard the rights of the estate, the foreign insolvency administrator has to undergo a rather burdensome process, which starts with an application for recognition of the foreign insolvency decree in Switzerland. In order to be recognised in Switzerland, the foreign bankruptcy decision has to meet the requirements set out in Article 166 PILA:

a the decision must have been rendered by the competent court at the seat of the debtor;
b the decree is enforceable in the issuing country;
c the recognition of the decree is not incompatible with Swiss public policy pursuant to Article 27 PILA; and
d reciprocity is granted by the issuing country.28

26 A detailed description of the status of these insolvency proceedings is contained in the Swiss chapter of The Insolvency Review (Edition 5).
27 Swiss law provides for more flexible rules on the recognition of foreign bankruptcy decrees on banks and other financial institutions.
28 The principle of reciprocity was further defined by the Swiss Supreme Court in its decision BGE 141 III 222 of 27 March 2015, stating that reciprocity is deemed to be granted where the foreign country
The same requirements apply to the recognition of a foreign composition agreement or similar proceedings. Even if the foreign insolvency decree is recognised, the foreign administrator is not entitled to act directly in Switzerland but may request for the opening of separate Swiss bankruptcy proceedings and the appointment of a local liquidator. The purpose of such ancillary proceedings is the liquidation of those assets that are located in Switzerland, thereby avoiding that Swiss creditors are disadvantaged. In a first step, only secured creditors and privileged creditors domiciled in Switzerland can participate. If said creditors are fully satisfied, any surplus is remitted to the foreign insolvency estate or the foreign creditor, but only upon recognition of the foreign schedule of claims in Switzerland. Recognition will be granted if creditors domiciled in Switzerland have been appropriately considered in the foreign schedule of claims. Otherwise, the surplus will be distributed to Swiss-domiciled third-class creditors.

VI  FUTURE DEVELOPMENTS

On 1 January 2019, the revision of the PILA with regards to the recognition of international bankruptcy decrees and foreign composition agreements came into force. The revision aims to modernise and facilitate the costly and burdensome proceedings for recognition of such foreign decrees and agreements and also includes certain changes regarding the effects of such recognition. Further, the revision aims at avoiding unnecessary ancillary proceedings (see Section V), in cases where there are no Swiss-domiciled secured or privileged creditors. The new PILA adopts five important amendments:

a. the reciprocity requirement has been deleted, thus considerably facilitating the recognition of foreign bankruptcy decrees;
b. insolvency decrees can be recognised if issued by the competent authorities at the ‘centre of main interests’;
c. if there are no privileged or secured creditors or creditors of a Swiss branch, and if the claims of unprivileged and unsecured creditors in Switzerland are adequately taken into account in foreign proceedings and these creditors were granted their right to be heard, Swiss courts can waive ancillary proceedings in favour of a foreign insolvency trustee upon the request made by the foreign bankruptcy administration;
d. Swiss authorities can cooperate with foreign bankruptcy authorities on related matters; and
e. creditors of unsecured and unprivileged claims of a Swiss branch of a foreign insolvent entity can be listed in the schedule of claims in the ancillary bankruptcy.

The revised PILA is an important step towards the harmonisation of international insolvency law and will facilitate the recognition of foreign insolvency decrees in Switzerland. The practical implementations of the revised PILA will still have to be considered more thoroughly.
Chapter 21

TURKEY

Sera Somay, Selin Barlin Aral and Doguhan Uygun

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

i Liquidity and state of the financial markets

As it is mostly the case in emerging markets, similar to the previous year it has been a year with ups and downs for the Turkish economy. Following the Turkish lira’s dramatic fall against the US dollar in recent months, the Turkish government has taken a number of measures to support the financial markets and stabilise the Turkish lira.

The second half of 2018 has been a difficult period for Turkey and its financial markets. Turkey has faced rating downgrades, the depreciation and volatility of the Turkish lira, an increasing inflation rate and rising distress in the private sector.

Fitch lowered the sovereign rating of Turkey to BB from BB+ in July 2018 and in August 2018, Moody’s lowered the sovereign rating of Turkey to Ba3 from Ba2, three notches below investment grade, and Standard & Poor’s decreased the rate to B from BB-. These downgrades took place shortly after the United States imposed sanctions against two Turkish government officials as a result of the detention of Pastor Andrew Brunson, who was held in prison by Turkey due to his alleged involvement in the failed coup of July 2016. After the release of Pastor Andrew Brunson on 12 October 2018, the United States lifted sanctions against two Turkish government officials in November 2018.

In September 2018, the Central Bank of Turkey raised its benchmark rate by 625 basis points to 24 per cent. This steep rise in interest rates and an amelioration of the relations with the United States stabilised the Turkish lira, which, as at August, had lost 36 per cent of its value against the dollar since the start of the year.

In October, Fitch downgraded the long-term foreign currency issuer default ratings of 20 banks and the viability rating of 12 banks. Although the Turkish banking sector has a strong track record and a moderate level of non-performing loans, these downgrades were based on the assumption that the sector could face challenging conditions in 2019 due to weaker economic growth, higher interest rates and an expected rise in non-performing loans. Furthermore, the Turkish banking sector is expected to roll over its loans at a higher cost.

ii Impact of specific regional or global events

In March 2018, Moody’s lowered the sovereign rating of Turkey to Ba2 from Ba1, two notches below the investment grade, and in May 2018, Standard and Poor’s decreased the rate to BB- from BB. S&P’s downgrade was not as a result of a scheduled review, but over growing concerns.
The reasons behind the downgrades were not because of regional or global events but mostly Turkey’s internal dynamics, which were cited by ratings agencies as a continued weakening of economic and political institutions, increased risk of external shock stemming from higher external debt, the wide current account deficit and high rollover requirements, a deteriorating inflationary outlook, the long-term depreciation and volatility of the Turkish lira and rising distress in the externally leveraged private sector.

The above-mentioned risks are in addition to Turkey’s traditional geographical risk owing to its close proximity to conflict zones such as Syria and Iraq. The geographical risk of Turkey is also a concern in relation to its trading partners such as Iran and Russia, which are natural trade partners for Turkey, but are also sanctioned countries.

Furthermore, the recent Istanbul’s mayoral elections dated 31 March 2019 has been voided by the Turkey’s top election body and orders rerun of Istanbul mayoral vote on 23 June 2019, such development increased the political instability.

iii Market trends in restructuring procedures and techniques employed during this period

The preferred restructuring technique in the Turkish market has always been informal restructuring, usually in the form of bilateral negotiations between the creditors and the debtors, mostly by way of refinancing of the bank loans. The main reason driving this trend, we believe, has been the fact that the formal restructurings generally provide broad discretion and authority to the courts over the creditors and that the banks are proactive in refinancing loans before a potential payment default for internal reasons.

iv Number of formal procedures entered into or exited during this period

Most restructurings are based on informal procedures, and this data is not available. However, the Ministry of Commerce stated in an oral interview that 356 different companies have applied concordat mechanism throughout 2018.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Introduction

As explained above, the Turkish market is generally dominated by informal bilateral restructurings, but there are two formal restructuring mechanisms provided by Turkish legislation. These are: (1) the concordat; and (2) the restructuring upon settlement. These mechanisms also constitute a remedy to avoid the bankruptcy. Postponement of the bankruptcy was also a formal and popular restructuring method, but was abolished as of March 2018.

ii Informal negotiations

Informal negotiations are usually opted for by the relevant parties owing to its confidential nature. Since all structured and formal restructuring options require, at one stage, filing with the court, the financial status of the debtor becomes public knowledge. Parties generally try to limit disclosure of a debtor’s financial difficulty so it is able to manage its reputation, ongoing vendor relations, as well as relations with other creditors.
This is also generally preferred by creditors for the same reasons; under formal bankruptcy their chance of collecting their receivables would diminish extensively, unless they are privileged or secured creditors.

However, it may not be easy to make these agreements work because, ultimately all creditors must consent to the restructuring arrangement (even if not under the same document) in order to ensure that inter-creditor relations and subordination of certain debts are secured. The risk of not including one of the creditors into these informal negotiations would be for initiation of bankruptcy procedures by such singled out creditor, which would prevent enforcement of the restructuring arrangement.

iii Concordat

Concordat is one of the formal restructuring options provided under the Enforcement and Bankruptcy Code No. 2,004 (EBC) for debtors who are unable to pay their due debts and who will not be able to pay their undue debts at the due date. Accordingly, an insolvent debtor, or a creditor who is allowed to file for bankruptcy, may initiate concordat proceedings before the commercial court. Upon filing for concordat, the court announces such in accordance with the EBC.

The debtor is required to provide the following for the term of concordat, during which the restructuring negotiations are expected to be held:

- a preliminary concordat project that: (1) clarifies at what rate and in which term the debtor will pay its debts, whether the debtor will sell its assets to pay the debts, invest capital in cash, utilise loans or find an alternative way to pay its debts; and (2) includes a proposed payment plan reflecting postponed due dates and reduced amount of receivables;
- a table reflecting the amounts offered by the debtor to be paid to the creditors upon the restructuring, and amounts that the creditors are likely to be paid if the debtor is declared bankrupt;
- the balance sheet of the debtor;
- a full list of the debtor’s creditors, including the amount due and priority of the creditors; and
- the financial reports prepared by independent audit companies, certified by the CMB or the Public Oversight Accounting and Audit Standards Authority, providing reasonable guarantee on the payment plan filed with the preliminary concordat project.

If concordat filing is made by a creditor, the court is required to grant a reasonable deadline to the debtor for submission of the above documents.

The concordat consists of a restructuring agreement between the debtor and its creditors under the court’s supervision in light of the preliminary concordat project. Therefore, concordat means the debtors’ postponement of the due debts or reduction of the debt amount, or both. The court appoints a temporary concordat trustee, or a panel of trustees, to review whether the restructuring can be successful and grants a temporary concordat term up to three months for such review. The three-month period may be extended up to five months by the court. If the court appoints a panel of trustees, one of them shall be an independent auditor who is authorised by the Public Oversight Accounting and Audit Standards Authority and approved as cap auditor.

During the temporary concordat term, the temporary concordat trustee prepares its report, which determines whether the concordat can be successfully completed, and files it
with the competent court. The competent court schedules an oral hearing before expiration of the temporary concordat term, at which the court may decide to: (1) reject the concordat claim if it is not convinced that the restructuring will be successful, if the bankruptcy is required for the protection of the assets, if the debtor does not comply with the instructions of the concordat trustee or acts against the interests of its creditors in bad faith, if the debtor withdraws its concordat request; or (2) grant a definitive concordat term for one year.

The restructuring agreement or the payment plan suggested by the debtor is required to be accepted by majority of the creditors, who have registered themselves with the concordat trustee. Moreover, the amount of the receivables of the creditors who accept the restructuring agreement must constitute the majority of the registered receivables’ amount. Alternatively, a quarter of the registered creditors and two-thirds of the registered receivables are sufficient for acceptance of the restructuring agreement or the payment plan. Secured and privileged creditors’ receivables are not taken into consideration in calculation of the quorums, but if the security does not cover the debt pursuant to the valuation made during the proceeding; the remaining unsecured debt will be taken into consideration. Therefore, the position of the unsecured creditors is essential during a concordat proceeding.

Once the required majorities are reached, the restructuring agreement should be submitted to the court for its approval within the definitive concordat term.

The court approves the concordat (the restructuring agreement or the payment plan) if the payment plan is proportional to the financial conditions of the debtor and if the court is convinced that the amount that will be paid to the creditors pursuant to the restructuring agreement is higher than the amount that potentially be collected by the creditors in the event of bankruptcy; the concordat must be more beneficial than bankruptcy for the creditors. The court is required to list the discount made by the creditors and the postponed due dates in its decision approving the restructuring.

Once approved by the court, the restructuring agreement binds all creditors of the debtor, except for: (1) creditors secured by a pledge on movables or mortgage; and (2) public debts related to rights in rem attached to real estate (e.g., taxes arising from the mere existence of the secured assets). If the court rejects the concordat request, it declares bankruptcy.

The EBC also regulates concordat by way of abandonment of the debtor’s assets. This entitles the transfer of the debtor’s assets to the creditors. In this case, the restructuring agreement will set out the details of the transfer instead of postponement of due dates and the discount of debts. The required quorum for this type of concordat is the same with ordinary concordat. If approved, the debtor’s assets will be shared by the creditors or be liquidated through a liquidator appointed by the creditors. Concordat by way of abandonment of the debtor’s assets is very rare in practice.

iv Restructuring upon settlement

The EBC also regulates restructuring upon settlement for companies that are insolvent, nearly insolvent or are not able to pay their debts on time. This alternative is a negotiation scheme between the debtor and the creditors. The restructuring is finalised if agreed by the required majority, consisting of: (1) a simple majority of those creditors who are affected

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2 *Mal varlığa son terciyle konkordato.*
by the restructuring and participated in the voting, and (2) the receivables of such simple majority corresponding to two-thirds of the receivables of the creditors who are affected by the restructuring and participated to the voting.

The restructuring document once finalised should be submitted to the competent commercial court for approval; accordingly, although the court is not involved in the negotiations, it is still required to confirm or reject the restructuring plan. This is also not a commonly exercised restructuring option in the Turkish market.

v The taking and enforcement of security during formal restructurings

Only the secured creditors may initiate the debt-collection proceedings during the definitive concordat term or continue the debt collection proceedings initiated before the grant of the definitive concordat term. However, the liquidation of the security is prohibited. In other words, even the secured creditors cannot finalise the debt collection proceedings. It is worth stating that the unsecured debts will not accrue interest during the definitive concordat term unless the restructuring agreement provides otherwise.

Further, during the definitive concordat term, the debtor cannot give any security or guarantee, transfer its immovables (or the main equipment of its plants) or make gratuitous transactions unless the court permits to do so. The purpose of this provision is protecting the assets of the debtor to avoid worsening the conditions of the creditors. Finally, the secured creditors can enforce their security during the proceeding. Moreover, the individual debt collection proceedings are not suspended, and new proceedings may be filed unless the relevant court orders an injunction to prohibit them. The secured creditors can proceed with the debt collection proceedings during the concordat term. The creditors’ table prepared in respect of Article 206 of the EBC outlines the priorities among the receivables or debts. Accordingly, the secured claims through a pledge on movables or mortgage are prioritised for proceeds of the security; they are solely preceded by the costs for the liquidation of the security. After the payment made to the secured creditors and reserving the liquidation costs, the public debts related to the security are paid.

vi Duties and liabilities of directors and shareholders of companies in financial difficulties

Liability of the board

According to Article 376 of the TCC, the board members may be held liable for the losses incurred by the company, if the losses or damages arising from their negligence or fault; such as, breach of the relevant provisions of the applicable law or articles of association. There should also be causality between the loss or damage and the negligent or faulty action of the board.

In principle, damages claims against board members may be requested by the company itself or the shareholders. However, if the company suffering the damage is bankrupt, the creditors would also be entitled to seek damages from the Board. This right is only secondary though; the creditors’ can only exercise it if the bankruptcy administration has not filed a lawsuit to seek such compensation, pursuant to Article 556 of the TCC.

Further, a debtor may be convicted with imprisonment of six months to three years and a penalty up to 1,000 days owing to the unjustified reduction of a company’s assets after initiation of an enforcement proceeding or two years before the date of the initiation of an enforcement procedure in order to prejudice the creditor. If a company is found to be guilty, the board members (as the managing organ of the company) can be held personally liable for such crimes.
The members of the board may also be convicted to imprisonment of six months to two years for inflicting loss to a company’s creditors by non-payment upon the complaint of the relevant creditor pursuant Article 333/a of the EBC.

**Liability of the shareholders**

Under Turkish law: (1) a joint stock company’s liability against its creditors is limited with its assets; and (2) a joint stock company’s shareholders’ liability against the company is limited with their capital contribution in the company. As such, there is no look-through liability; the shareholder’s liability ends with the payment of the capital contribution. Limited liability company’s shareholders, on the other hand, may be held personally liable for payment of a company’s debts, especially for the public debts.

There are two exceptions to the above principle: (1) the liability of the parent company, which would be the controlling or holding entity, and (2) piercing the corporate veil:

**Liability of the parent company**

A parent company can be liable if there is an abuse of power or unlawful act of the parent company instigating a loss or damage to its subsidiary. In such a case, normally the TCC requires the loss to be reimbursed by the parent company within the same fiscal year in which the loss has occurred. Otherwise, the shareholders and stakeholders (i.e., the creditors of the subsidiary) would be entitled to recourse directly to the parent company, or the board of the parent company.

The parent company's liability is limited to the losses of its subsidiary, and the parent company is only liable to reimburse the subsidiary; the creditors or the stakeholders cannot request payment from the parent company for their own receivables.

**Piercing the corporate veil**

Piercing the corporate veil (i.e., direct liability of the shareholders) is only applied in exceptional cases under Turkish law where the facts of the case deem it equitable. Therefore, there is not much case law on this; but, according to common principles, piercing the corporate veil can only be justified and would be equitable when there is fraud or the shareholders render the company, with no valid or reasonable purpose, excessively indebted and disproportionately so to the total value of its assets, against good faith principle. In such cases, the courts may decide to pierce the corporate veil and decide on holding the shareholders directly liable with their own assets against the creditors of the company.

If the shareholder of a company is held liable owing to lifting the corporate veil, usually the liability would vest on the majority shareholders (i.e., the minority shareholders who had absolutely no management control over the relevant entity would probably not be held liable for company actions).

In addition to the general principles set out above, Article 333/a of EBC provides that if the de jure or de facto executives of a company cause damage to the creditors by not paying all or part of the liabilities with the intention of causing damage to the creditors, the executives may be sentenced to imprisonment from six months to two years and a fine up to 500,000 lira, provided that the relevant actions do not constitute another offence.
Clawback actions or voidable transactions

Pursuant to Article 277 et seq. of the EBC, creditors of a Turkish debtor that is unable to pay its debts (the insolvent party) are entitled to apply to courts to invalidate certain transactions entered into by the insolvent party within five years of the date of the voidable transaction. The transactions that may be invalidated generally consist of those made for no consideration (including donations) or for a consideration that is significantly less than the actual value of the transaction.

The EBC provides different time limits to different types of transaction:

a donations and similar transactions: Transactions made without any consideration, such as donations, or transactions made with an insignificant consideration may be invalidated by the courts only if the transaction has taken place within the two years prior to the bankruptcy of the insolvent party. ‘Insignificance’ of the consideration in question would be evaluated on a case-by-case basis by the courts and experts, if necessary;

b transactions providing advantage to certain creditors: The following arrangements would be voidable if such arrangements are made within one year before the declaration of the bankruptcy of the insolvent party:

• the creation by the insolvent party of a pledge over its assets to secure an existing debt where such person had not previously promised to execute such pledge or mortgage;
• any payments made by the insolvent party other than with money or ordinary payment methods;
• prepayment of debts that are not yet due; and
• annotations made to the title deed for purpose of strengthening contractual rights.

The court would not declare any such arrangements void if third parties that benefit from such security arrangements prove that they were not aware of the financial condition of the insolvent party; and

c disposals made in bad faith: Disposals made by the insolvent party acting intentionally against the interests of its creditors may be invalidated by the creditors of the insolvent party if such disposal took place within the five years prior to the initiation of either attachment or bankruptcy proceedings against the insolvent party. In order for such an invalidation request to succeed, the creditors must prove that the third-party purchaser of such assets, at the time it entered into the transaction, was aware or should have been aware of the insolvent party’s financial condition and of the fact that the insolvent party was not acting in good faith.

Note that a third party that has acquired assets of the insolvent party through a transfer of business or through transfer of commercial assets of a business is deemed by the EBC to be aware of the insolvent party’s financial condition and of the fact that the insolvent party was not acting in good faith. The third party may, however, evade such assumption by: (1) giving three months’ prior written notice to the creditors of the insolvent party, or (2) announcing the transfer via visible notes at the business premises and publishing the upcoming transfer in the Trade Registry Gazette, or by any other suitable means that would reach the creditors, three months prior to the transaction.
III RECENT LEGAL DEVELOPMENTS

i Recent legislative developments

Recently, Turkey undertook a serious overhaul by drastically amending its bankruptcy and enforcement law with a focus on restructuring mechanisms. One of the commonly exercised formal restructuring techniques was postponement of bankruptcy. However, this scheme provided relatively unbalanced rights to the insolvent party because upon its commencement the creditors were left out of the process. With the enactment of the Law No. 7,101 on Amendments to the Enforcement and Bankruptcy Code and certain other Codes (the Law) on 15 March 2018 the postponement of bankruptcy was completely removed. The Law introduced a revised mechanism of concordat that is actually not a new concept under Turkish law and had always been regulated but had not been opted for in practice.

Furthermore, a recent change in the capital markets legislation has strengthened the step-in rights of banks for listed companies. As a result of this change, a mandatory tender offer to minority shareholders will not be triggered by the transfer of control to lenders acquiring control based on a share pledge.

On 19 December 2018, with Law No. 7,155 on Initiation of Enforcement Proceedings Regarding Monetary Claims Arising from Subscription Agreements, several amendments made in the EBC in order to improve some provisions to prevent the abuse of above explained concordat mechanism. Moreover, the Banks Association of Turkey has published a financial restructuring framework agreement (the framework agreement) on 11 September 2018 and amended it further on 29 January 2019 in line with the Regulation on Restructuring of Debts Payable to Financial Sector issued by the Banking Regulatory and Supervision Agency (BRSA) on the Official Gazette dated 15 August 2018 and numbered 30510 (as amended from time to time) (the Regulation).

As per Article V of the framework agreement, a debtor (1) with a minimum credit balance of 100 million Turkish lira (including cash and non-cash loans) to Turkish financial institutions at the time of application, (2) whose indebtedness is classified under Class 1, Class 2 or frozen credit as per the relevant BRSA regulations and (3) against whom enforcement proceedings has not been initiated by Turkish financial institutions can apply for a restructuring under the framework agreement.

Debtors falls into the scope of the framework agreement if its indebtedness to Turkish financial creditors exceed 100 million Turkish lira. In such case, the debtor can apply for a restructuring under the framework agreement.

Turkish financial institutions that have signed the framework agreement (TFIs) are members of this consortium. Financial creditors who have not signed the framework agreement and who would like to be a member of the consortium, should sign the framework agreement and should be approved by at least 30 per cent of the number of consortium creditors and by the consortium creditors holding at least 75 per cent of the total indebtedness.

Foreign financial creditors are entitled to join the restructuring under the framework agreement on a case-by-case basis without any approval of the other consortium creditors. Alternatively, foreign financial creditors may choose to conduct separate restructuring proceedings in parallel with the restructuring under the framework agreement. In such case, the framework agreement requires information flow between the parties to these parallel restructurings.

As per Article IX of the framework agreement, upon application of the debtor for the restructuring in line with the framework agreement, a standstill period of at least 90 days starts. The standstill period can be extended to 150 days. During the standstill period, any
enforcement action initiated by the financial creditors who signed the framework agreement and joined the restructuring (framework creditors) is suspended and no further enforcement action can be initiated by the framework creditors.

Upon application for a restructuring, the debtor needs to propose a restructuring plan. If the restructuring plan proposed by the debtor is accepted by the framework creditors with at least two-thirds of the total indebtedness, then such plan becomes binding on all the framework creditors. Extension of new credit requires the approval of framework creditors with at least 90 per cent of the total indebtedness and any haircut or payment in kind is possible if approved by 100 per cent of the framework creditors.

ii Key cases

The restructuring of the US$ 4.75 billion loan provided to Oger Telecom AS (OTAS) by a syndicate of Turkish and international banks in May 2013 is one of the most important restructurings in Turkey, if not the most important. This loan was the largest corporate loan when issued and was provided for the purpose of refinancing of the acquisition financing of Türk Telekom, which is by nature a strategic asset in Turkey. Türk Telekom is a listed company controlled by OTAS, but the Turkish Treasury has a golden share in the company. Furthermore, there are step-in rights of the Turkish Treasury if OTAS defaults. It is known in the market that OTAS has failed to repay its loan since September 2016. The restructuring is still ongoing as of the date of this chapter.

On the other hand, one of the most notorious bankruptcy cases of this year was bankruptcy of Asya Katılım AŞ, widely known as Bank Asya. The Banking Regulation and Supervision Agency decided to cancel the banking licence of the Islamic lender Bank Asya on 22 July 2016. The bank was claimed to have close connections with the Fethullah Terror Organisation (FETO), which is the group behind the defeated coup attempt dated 15 July 2016. Following this, the Istanbul First Commercial Court ruled on the bankruptcy of Bank Asya on 16 November 2017. Liquidation of Bank Asya’s assets is still ongoing before the Istanbul First Bankruptcy Office and several litigations in relation to thereto are also pending. In 2018, some of Turkey’s well-known companies such as Hotiç (an 80-year-old Turkish shoe and accessories brand with 152 sales points), Gilan (Turkey’s renowned jewellery brand), Keskinoğlu (a leading poultry company that has been a leader in supplying eggs and chicken meat throughout Turkey for 55 years and has exported to 75 countries) and many of the well-known companies active in construction sector have applied concordat mechanisms mostly as a result of their problems with short-term payments and the shortage of cash flow in the markets, unpredictable hike in interest rates because of the excessive depreciation of the Turkish lira and liquidity.

As a result of the increasing number of the companies that declared concordat and the misuse of the mechanism hereby; the concordat procedure has been tightened through the amendments made within the EBC on 19 December 2018, for example, it has become more difficult to be appointed as concordat trustee or the inspection of the preliminary concordat project has become more meticulous. Consequently, following these amendments, the number of concordats have decreased and the number of bankruptcy decisions rendered by the commercial court has increased accordingly.

iii Impact of insolvency and restructuring on the market

The most significant insolvency in the market is the insolvency of Bank Asya, which was declared bankrupt on 16 November 2017 following the cancellation of its banking licence on
22 July 2016. However, the insolvency of Bank Asya has been considered as an exceptional case by the market since the cancellation of the banking licence was because of criminal acts rather than the financial condition of the bank.

In terms of restructuring, the two major restructurings that affected the market are the restructurings of two large conglomerates, Yıldız and Dogus. One of the restructurings was initiated by the fact that a Turkish bank did not agree to roll over the foreign currency short-term loans at the hold-co level. This created a concern among the borrowers over unsecured short-term borrowings in foreign currency, and we are observing series of refinancings converting the unsecured short-term foreign currency debt to secured but long-term foreign currency debt. In other words, borrowers are concerned of rollover exposure. This domino effect in the Turkish market is further detailed below.

Generally, construction and energy are two of the industries that are highly affected by the negative market conditions in Turkey. As a result, there has been a number of insolvent SME construction companies and there are major restructurings in energy sector, along with an increase in energy M&A deals. One of the larger bankruptcies in construction is the bankruptcy of Inanlar, which was a reputable construction and real estate development company. The rumoured bankruptcies in the construction sector made potential purchasers reluctant to acquire uncompleted real estate projects, which further negatively affects the cash flow of ongoing real estate projects. As stated above, the reflection of the financial difficulties of energy companies has been in the form of increased M&A deals.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

Following the Turkish economic crisis in 2001, postponement of bankruptcy has been the most frequently used technique in restructuring. However, the system was abused by some companies that were creating or reflecting fictitious debts to be able to apply for postponement of bankruptcy in order to benefit from halting payments. Accordingly, creditors were bewailing this owing to the abuse of the postponement of bankruptcy by malicious debtors. As explained above, with the enactment of the Law on 15 March 2018, the postponement of bankruptcy has been completely abolished. New rules and regimes were introduced to the concordat scheme, with an aim to simplify the process and promote such insolvency and restructuring methods. We believe concordats will be the new popular restructuring technique method in Turkish market.

Regarding the significant restructuring transactions of 2018 in Turkey, as explained above, the ongoing restructuring of the US$4.75 billion loan provided to OTAS by a syndicate of Turkish and international banks in May 2013 is one of the most important restructurings of Turkey.

The restructuring of the unsecured short term foreign currency debt of major holding companies was a new type of restructuring in the market during this year. Short-term foreign currency funding was advantageous to Turkish holding companies since it was unsecured and well priced. However, in the current market conditions, companies are taking a rollover risk since Turkish banks might not rollover such loans, and even if they do, this might be at a very high price. Therefore, borrowers are requesting banks restructure such loans. The two major examples of this type of restructuring that are also called ‘performing restructurings’ are the restructuring of Yıldız and Dogus. Yıldız restructured loans amounting to US$7 billion. Dogus Holding, a conglomerate active in the automotive, construction, media, food and
Turkey

entertainment industries, disclosed that it is in talks with banks for the restructuring of loans worth up to €2.3 billion. This restructuring was completed very recently, just eight months following Dogus Holdings’ initial public announcement thereof. Both of the restructurings were made on a consensual basis, that is, with mutual agreement of lenders and the borrower.

The third type of restructurings are refinancing of existing loans of energy companies and construction companies. Both industries were hit by the market conditions and are in need of refinancing of their existing debt and extending maturity in order to be able to service the debt. On the construction side, decreasing real estate prices owing to excessive supply and the rise of interest rates along with the increase of construction costs put the pressure on the construction market. The energy sector, which has significant hard currency borrowings, was hit by devaluation of Turkish lira along with rising natural gas and oil prices, as well as lack of realisation of the projected growth in the energy markets. Turkish banks (which have one of the lowest NPL ratios in the emerging markets) are accommodating such refinancing requests in most of the cases to keep their NPL ratios as low as possible.

In terms of market trends, the refinancing packages offered by banks include a more restrictive set of covenants including financial covenants and more restrictive cash sweep provisions transferring all excess cash to banks. In some cases, Turkish banks are requesting borrowers appoint independent professional advisers on the management of the company to strengthen governance.

One of the key developments in connection with wave of restructurings in the market is the restriction by the Central Bank of Turkey of foreign currency borrowings of Turkish corporates with no foreign currency revenues except in limited cases. With a change to Decree No. 32 on the Protection of Turkish lira in effect since 2 May 2018, Turkish corporates are not authorised to borrow in foreign currency from Turkey or from abroad except if they have foreign currency revenues, in which case their borrowings cannot exceed their revenues of the three past years; if they do not have foreign currency revenues then they should have an outstanding cash loan balance of US$15 million or more or they should benefit from other exceptions stated in the Decree.

V  INTERNATIONAL

i  General

Although the European Convention on Certain International Aspects of Bankruptcy was signed by Turkey in 1990, the Convention has not come into force. Turkey, accepted International Arbitration Law No. 4,686, mainly a reflection of the UNCITRAL Model Law; it has not adopted the UNCITRAL Model Law on Cross-Border Insolvency. As a result, there are no developments or key cases under the EC Regulation in Turkey since there is no international treaty, model law or EU legislation to which Turkey is a party in insolvency and bankruptcy restructuring.

ii  Recognition and judicial assistance to proceedings commenced in another jurisdiction

According to Article 154 of EBC (which regulates the competent authority for reviewing bankruptcy filings), there are contradictions and different approaches adopted by the Court of Appeal and the doctrine with regard to the recognition of foreign bankruptcy proceedings. Some scholars consider this Article an exclusive jurisdictional rule, while others assert that
foreign bankruptcy decisions given in the country where the debtor’s headquarters is located can be recognised in Turkey. As a result, there is a risk that Turkish courts will not recognise the bankruptcy decision given by foreign courts because of the principle of territorial sovereignty.

VI  FUTURE DEVELOPMENTS

We expect the wave of restructurings to continue in Turkey and the restructuring methods to further develop based on the needs of the market. We do not expect any material changes to restructuring legislation for the time being.
I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

The US economy outperformed expectations in the first quarter of 2019. Advance estimates indicate that gross domestic product (GDP) grew by 3.2 per cent,² above the predicted 2.2–2.5 per cent growth. The US Department of Commerce attributes much of this growth to increased state and local government spending and to companies stockpiling inventory of raw and finished goods. The strong first quarter notwithstanding, the US Federal Reserve has acknowledged that the economy is beginning to cool after two years of robust growth. GDP in 2018 grew by a strong 2.9 per cent (annualised), but Q4 2018’s 2.2 per cent growth rate was markedly smaller than the previous two quarters’ 4.3 per cent (Q3) and 3.4 per cent (Q2) growth.³ The US Federal Reserve forecasts GDP will grow by 2.1 per cent in 2019 (although this prediction pre-dates the unexpectedly strong first quarter), followed by around 1.9 per cent in 2020.⁴ The slowdown is attributed to the fading impact of the 2017 US tax code reforms, the looming trade war with China and economic weakness in Europe and China.⁵ The cooling economy may moderate the job market in 2019, after two years of remarkable growth. The unemployment rate reached new lows in 2018 and declined to 3.6 per cent in April 2019, the lowest rate since December 1969.⁶ By contrast, the stock market was rocked by volatility in 2018. The Dow Jones Industrial average swung 1,000 points in a single session five times in 2018; previously, it had only done so three times in its history.⁷

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1 J Eric Ivester is a partner at Skadden, Arps, Slate, Meagher & Flom LLP. Mr Ivester acknowledges and gratefully appreciates the substantial work and assistance provided by Julie Lanz, an associate at the firm, in preparing this chapter.


5 id.


Stocks performance in 2018 was lower than at any time during the last 10 years, but the markets have rebounded in 2019 and have regained all the ground they lost since December 2018. The S&P 500 (a benchmark for the overall strength of the stock market) has surged more than 22 per cent since the new year, approaching its September 2018 all-time high of 2,940. Most commentators expect a good year for the stock market.

Although the federal funds rate has increased since last year (as of March 2019 the rate is 2.5 per cent, up from 1.75 per cent in March 2018), debt still remains cheap and readily available. The US Federal Reserve has indicated it does not intend to raise rates this year. Accordingly, companies in distress continue to roll over and refinance their debt rather than explore court-supervised restructurings. Bankruptcy filings have fallen steadily since 2010, and filings in 2018 were down further still. As of 31 December 2018, total Chapter 11 filings were down 1.5 per cent and business filings were down 3.9 per cent year-over-year. Public company (defined as companies with publicly traded stock or debt) filings fell from 58 in 2018 from 71 in 2017. The combined asset value of the public company filers was only US$52 billion in 2018, compared to US$106.9 billion in 2017.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

Title 11 of the United States Code (Bankruptcy Code) governs bankruptcy cases filed in the United States. The Bankruptcy Code is premised on the theory that an honest debtor deserves a fresh financial start and thus relief from its unsecured debts. It endeavours to allow for this fresh start, while at the same time balancing the rights of the debtor’s various constituents as fairly and equitably as possible. The Bankruptcy Code was enacted by Congress in 1978 and has been amended several times - the last substantial amendment was in 2005.

The filing of a petition by the debtor (for corporations, this is usually a petition for relief under either Chapter 7 or Chapter 11 of the Bankruptcy Code) commences the bankruptcy case. There is no requirement that a company be ‘insolvent’ to commence a voluntary bankruptcy case. Rather, case law has developed to require only that a petition be filed in good faith. Immediately upon filing a petition, the debtor obtains the benefit of an automatic stay. The stay prohibits most creditors from taking actions against the debtor and its property on account of pre-petition liabilities or agreements without express authorisation.

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8 id.
12 id.
14 id.
15 11 USC, Sections 101–1532.
from the bankruptcy court. The stay gives the debtor the necessary ‘breathing space’ to complete its reorganisation or orderly liquidation consistent with the terms of the Bankruptcy Code.

A company hoping to reorganise or liquidate with its management in place will file a petition under Chapter 11; a company with no option but to liquidate under court supervision will commence a Chapter 7 case. Banks, savings and loan associations, insurance companies, stockbrokers and commodity brokers are not eligible to file for Chapter 11 protection. In general, these types of entities are liquidated under other federal or state winding-up laws or, in the case of stockbrokers and commodity brokers, under their own sub-chapter of the Bankruptcy Code.

Unlike many insolvency regimes in other countries, in a Chapter 11 case, the debtor’s management and directors generally remain in place and continue to manage the business and guide the restructuring (the filing entity is referred to as a debtor-in-possession). A trustee is rarely appointed to oversee a Chapter 11 debtor’s operations unless the situation suggests that one is necessary. By contrast, in a Chapter 7 case, a trustee is appointed to manage the liquidation.

The bankruptcy court judge is typically heavily involved in the bankruptcy case. Indeed, many of the debtor’s activities (e.g., financing, major asset sales, plan of reorganisation) must be brought to the bankruptcy court judge for approval. Also, the US Trustee (UST), a representative of the Department of Justice, acts as a ‘watch dog’ over the debtor’s case - particularly at the outset before creditors have had time to organise. In a Chapter 11 case, the debtor-in-possession’s actions will often be subject to scrutiny by one or more ‘official’ committees appointed by the UST. The most common official committee is one composed of unsecured creditors. In larger cases, the committee typically retains its own professionals (including counsel) to represent the unsecured creditors’ interests, and the debtor pays for the cost of these professionals. In some cases, equity holders or retirees will convince the UST to appoint a separate committee for their constituents, especially in cases in which it appears the debtor may be solvent. Other official committees can be formed to represent other creditor groups, although such committees are rare, except in cases driven by mass torts such as asbestos liability.

The goal of a debtor in commencing a Chapter 11 case is to confirm and consummate a Chapter 11 reorganisation plan. Unless a trustee has been appointed, the debtor initially

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16 The few exceptions include certain offsets under various financial contracts, taxes and the actions by certain governmental authorities who are asserting their police and regulatory powers. See 11 USC, Section 362(b).
17 Note, however, that holding companies of banks, insurance companies and brokers are eligible to file for Chapter 11 relief: thus the filings of Lehman Brothers Holdings Inc and the holding company of Washington Mutual Bank. Insurance companies are liquidated under state law procedures, which differ among the 50 states. Banks are liquidated under the Federal Deposit Insurance Act.
18 11 USC, Section 1107.
19 11 USC, Section 1104. Fraud is the main reason a trustee is appointed.
20 11 USC, Section 1103.
has the exclusive right to file a reorganisation plan. The exclusivity period, however, is not indefinite. Indeed, with the bankruptcy court’s permission, plan exclusivity can be extended, but only to a maximum of 18 months after the petition date.

Before a debtor can solicit votes on its reorganisation plan, it must provide creditors with a disclosure statement that has been approved by the bankruptcy court. The bankruptcy court does not approve the contents of the disclosure statement; rather, its role is to ensure that the disclosure statement contains ‘adequate information’ to permit a creditor to make an informed decision to accept or reject the related plan. Following approval of the adequacy of the disclosure statement, the debtor may solicit votes from creditors and equity holders entitled to vote on the plan. Parties who are entitled to vote on the plan are those whose debt claims or equity interests are being affected by the plan, unless they receive no distribution, in which case they are deemed to have rejected the plan. Groups of creditors and equity holders will be categorised into different ‘classes’. If the requisite votes are received, the debtor will seek confirmation, or approval, of the plan by the bankruptcy court.

Aside from the required votes, the most critical requirement of the Bankruptcy Code for the plan is the ‘best interests of creditors test’. This test requires that each creditor either accept the plan or receive under the plan a distribution equivalent to what it would receive if the debtor were to liquidate rather than reorganise. In some cases, the test requires valuation of property given to dissenting creditors. Because valuation is a complex and fact-intensive undertaking, a ‘best interests fight’ can lead to time-consuming and expensive litigation.

The second critical requirement is that at least one ‘class’ of claims votes for a plan if there is a class of impaired – or affected – claims. For this vote, the votes of insiders do not count. A class will be deemed to accept the plan if two-thirds in amount and more than 50 percent in number of creditor class members vote in favour of it. In the event that equity security holders are proposed to receive a distribution, classes of equity security holders must vote for the plan by at least two-thirds in amount.

Usually, at least one class will either affirmatively reject or be deemed to have rejected the plan because that class is not slated to receive a distribution under the plan. In those cases, the debtor can confirm its plan by ‘cramming down’ these creditors or equity security holders. ‘Cram down’ requires the debtor to prove that the plan does not discriminate unfairly and is fair and equitable with respect to each class of claims or interests that is impaired under the plan and has not accepted it. The ‘fair and equitable’ test is fairly straightforward and basically follows an absolute priority waterfall, under which secured creditors are entitled to full payment (at least over time) before unsecured creditors and equity holders receive a distribution. Despite this rather simplistic concept, valuation and issues regarding the present value of future payments to secured creditors are often hotly contested. The ‘unfair discrimination’ requirement is more difficult to grasp but, at a minimum, it prevents creditors and interest holders with similar legal rights from receiving materially different treatment under a proposed plan without compelling justification for doing so.

21 Note that if a Chapter 11 trustee is appointed, neither the debtor nor the Chapter 11 trustee has the exclusive right to file a plan. 11 USC, Section 1121(c)(1).
22 11 USC, Section 1121(d)(2)(A).
23 USC, Section 1125(b).
24 id. In some cases, the disclosure statement can be approved at the time the plan is approved.
25 See 11 USC, Section 1129(a)(7).
26 id.
27 11 USC, Section 1129(b)(1).
Confirmation of a reorganisation plan provides a reorganising Chapter 11 debtor with the fresh start that most debtors hope to obtain by reorganising under the Bankruptcy Code. The discharge that the debtor receives under the Bankruptcy Code is key to the ‘fresh start’. This discharge bars creditors and equity security holders from looking to the debtor for satisfaction of claims owed to them prior to the commencement of the Chapter 11 case. Rather, their sole source of recovery is the distribution proposed to be made to them under the plan. Corporate debtors liquidating under either Chapter 7 or Chapter 11 of the Bankruptcy Code, however, do not obtain a discharge.

i Absolute priority rule
A basic premise under the Bankruptcy Code is that, in the absence of consent, distributions to creditors must follow the ‘absolute priority rule’. In applying this rule, lower priority creditors may receive a distribution only after more senior classes are paid in full. Secured creditors are first in the priority scheme. Secured claims typically include pre-petition lenders and trade creditors with security interests (including holders of mechanics’ liens and materialmen’s liens). ‘Administrative expense’ claims are second in priority. Included in this bucket are claims relating to the post-petition operations of the debtor, and ‘cure’ claims that arise when debtors ‘assume’, or agree to be bound by, pre-existing contracts. The Bankruptcy Code also elevates to administrative expense priority status certain pre-petition claims of vendors of goods that would otherwise be treated as general unsecured claims. Next in order of priority come ‘priority claims’, which include certain pre-petition wages and commissions, employee benefit plan contributions, unsecured claims in connection with certain prepayments for goods or services from the debtor (e.g., the pre-petition purchase of goods ‘laid away’ with the debtor, up to a cap) and certain taxes. A Chapter 11 reorganisation plan must provide for payment of administrative expense claims and priority claims in full on the plan’s effective date, although individual creditors may agree to a payout over time.

General unsecured claims, in terms of priority, come after secured claims, administrative claims and priority claims, but before subordinated debt claims. Equity interests (including equity-related damage claims that are treated as equity) are lowest on the distribution ‘waterfall’ and, as a result, equity holders rarely receive a bankruptcy distribution.

ii Treatment of contracts in bankruptcy
A debtor generally has the power to determine those executory contracts and unexpired leases by which it will continue to be bound following its reorganisation. A contract is usually found to be ‘executory’ when both the debtor and the non-debtor party to the contract have material performance obligations outstanding. If the debtor chooses to assume (or keep) a contract, it will be bound under all the terms of the agreement. Alternatively, if the debtor no longer seeks to be bound by the agreement, it will ‘reject’ it. Upon rejection of a contract, the debtor is no longer required to perform and the contract is deemed breached as of the date the bankruptcy commenced. Damages resulting from such a breach are referred to as

28 Consent is obtained through the votes of classes of claims and interests.
29 The payments may be simultaneous, provided that the senior creditor will eventually be paid the present value of their claims in full.
30 See, generally, 11 USC, Section 507(a).
‘rejection damages’ and are generally given the lowest priority status (i.e., prepetition general unsecured claims). Under certain circumstances, a debtor may be able to assign its interest in a contract or lease to a third party.31

In the event a debtor does not assume an agreement, the default option under the Bankruptcy Code is rejection.32 The deadline to make the assumption or rejection decision with respect to unexpired leases and executory contracts (other than leases for non-residential real property) is the date a Chapter 11 plan is confirmed by the bankruptcy court. The deadline for a debtor to assume or reject an unexpired lease for non-residential real property can be much sooner (i.e., generally 210 days after commencement of the bankruptcy case, absent landlord consent). In a case where leased real property locations number in the hundreds, as in large retail cases, the debtor should make preliminary decisions on which leases it wants to assume or reject prior to commencing its bankruptcy case, and thereby attempt to avoid assuming leases it may not ultimately need.

iii Security interests

In the United States, Article 9 of the Uniform Commercial Code (Article 9 and the UCC, respectively), as adopted by each of the 50 states, generally applies to any security interest created by contract in personal property and fixtures to secure payment or other performance of an obligation.33 There are three components to the creation and enforcement of a security interest under Article 9 – attachment, perfection and priority. Under Article 9, a security interest attaches to collateral at the moment it becomes enforceable against the debtor. Only an attached security interest may be perfected under Article 9. Perfection is the process by which a secured party gives public notice of its security interest in collateral. A perfected security interest will prevail over claims of an interest in collateral by other parties (including liens of creditors using the judicial process to obtain liens on the collateral). State law, generally uniform throughout the United States, will dictate the method for perfecting a consensual security interest.

In many cases, two or more creditors may have security interests in the same collateral. In such cases, Article 9 provides general rules as to the ranking of security interests – that is, which security interest takes priority over the others. As a general rule, an earlier-secured party will prevail over later-secured creditors. There are, however, exceptions to this general rule and, therefore, practitioners must refer to Article 9 in the applicable jurisdiction relevant to a particular transaction or consult local counsel.

Article 9 has a critical interplay with the Bankruptcy Code. Upon the bankruptcy filing, the debtor steps into the role of a ‘hypothetical lien creditor’.34 This means, in general, that it may void any unperfected security interest. Accordingly, it is critically important for secured creditors to ensure that their liens are properly perfected, especially when transacting

31 11 USC, Section 365(f). See also 11 USC, Section 365(c) for additional assignment restrictions.
32 11 USC, Section 365(d)(1).
33 Each of the 50 states and the District of Columbia have adopted their own version of the UCC. All references to Article 9 contained herein are to Article 9 as set out in the model UCC. Practitioners are encouraged to refer to Article 9 as adopted in the jurisdiction relevant to each particular transaction, to consult local counsel, or do both.
34 See 11 USC, Section 544.
business with a distressed company on the verge of bankruptcy. Again, while there are some variations in the details, security interests are usually ‘perfected’ by filing in a governmental registry or by taking possession of the collateral.

Whereas the UCC, which deals with the creation of security interests in personal property, is fairly uniform as adopted in all 50 states, security interests or mortgages in real property are controlled by different laws in each of the 50 states. However, most state laws provide for the recording of mortgages in local governmental offices. As with security interests in personal property, a bankruptcy trustee or debtor-in-possession can avoid improperly recorded mortgages by stepping into the shoes of state-law creditors.

iv Clawback actions

The Bankruptcy Code gives a debtor certain ‘avoidance powers’ to recover property transferred by the debtor to third parties before the petition date. Generally, these avoidance actions fall into two categories: the transfers had the effect of preferring one creditor over others; or the transfers were made for the purpose of hindering, delaying or defrauding creditors from collecting on their claims.

‘Transfer’ is defined broadly and encompasses payments as well as the granting and perfection of liens. Transfers that the debtor can prove to be fraudulent or preferential can be treated as voidable transfers. In many instances it is unnecessary to prove that the debtor or the recipient, or both, had a wrongful motive – the Bankruptcy Code is concerned only with ensuring equal treatment of creditors, even if that means unwinding well-intentioned arm’s-length transfers of property. That said, the recipient of a voidable transfer has certain affirmative defences to shield all or a portion of the transfer from the debtor.

The most common voidable transfer is referred to as a ‘preference’. Preferences are those payments a debtor makes to a pre-petition creditor on the ‘eve’ of the bankruptcy filing35 that allow such creditor to receive more on account of its claim than it would have received had it waited in line with other creditors and received its distribution in a hypothetical liquidation of the debtor pursuant to Chapter 7 of the Bankruptcy Code. The amount the creditor received in connection with the transfer will be voidable, subject to certain defences, such as receipt of the transfer in the ordinary course of business. To the extent the transfer is avoided, the preference recipient would have a claim against the debtor.

Fraudulent transfers that can be recovered include transfers made with the actual intent to hinder, delay or defraud creditors. Recoverable fraudulent transfers also include transfers for inadequate consideration when the debtor (transferor) is insolvent, undercapitalised or was unable to pay its debts as they became due. The Bankruptcy Code has its own fraudulent transfer provisions, but the debtor-in-possession may also prosecute such claims under similar state law provisions.

35 The reach-back period is generally 90 days, unless the transferee is an ‘insider’ of the debtor, in which case the reach-back period is one year.
III SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

i Pre-planned bankruptcies: a quick escape from an all-out bankruptcy

Pre-planned bankruptcies continue to be a useful tool for debtors as they try to manage the time and expense of a US bankruptcy filing. There are two types of pre-planned bankruptcies: pre-packaged and pre-negotiated bankruptcies. Pre-packaged bankruptcies (pre-packs) are typically utilised by companies seeking to right-size their capital structures (e.g., to address maturities or deleverage from existing secured lender or bondholder indebtedness). The pre-packaged bankruptcy mechanism is not useful for companies seeking to achieve an operational turnaround or that need to modify other significant liabilities such as pension, retiree medical or mass tort liabilities.

In a pre-pack, the Chapter 11 case is commenced after the plan proponent has obtained the requisite votes to approve a reorganisation plan. In pre-negotiated plans, the creditors entitled to vote on the plan indicate their support for the plan before the commencement of the case, often in the form of a ‘lock-up’ agreement, but the vote occurs following the commencement of the case. It is common for pre-packs to last less than 60 days. Absent complications, pre-negotiated bankruptcies will take 45 to 60 days longer than a pre-pack. These periods are far shorter than the duration of Chapter 11 cases that are not pre-planned or that require operational fixes.

The pre-pack concept is an important negotiation tool as companies attempt to obtain concessions from their constituents. The requirement to achieve an accepting class of creditors (and, therefore, to bind non-accepting class members) under the Bankruptcy Code is two-thirds in amount and greater than one-half in number of those creditors who cast a vote. If acceptance is received from almost all of the creditors from whom votes are solicited, companies will often consummate the restructuring without filing for bankruptcy. Moreover, the threat of a pre-pack makes it less likely that a filing will be required, because there is little reason for creditors to withhold their acceptance once the company has received acceptances sufficient to satisfy the minimum threshold for an accepting class in the Chapter 11 context.

Pre-planned Chapter 11 filings were less common in 2018 than in 2017; 10 per cent of all public company Chapter 11 filings were pre-planned (versus 23 per cent in 2017). Notably, the largest Chapter 11 filing in 2018 was a pre-packaged case: iHeart Media, Inc. filed with US$12.8 billion in pre-petition assets. In 2019, two pre-packaged cases have broken records for the shortest Chapter 11 case. FullBeauty Brands emerged from bankruptcy just 22 hours after filing for Chapter 11 protection in January 2019, a record that was beaten only three months later when Sungard Availability Services completed its Chapter 11 proceeding in only 20 hours.

36 11 USC, Section 1125(g) of the Bankruptcy Code provides that an acceptance or rejection of the plan may be solicited from a holder of a claim or interest before the commencement of the case, provided that such solicitation complies with applicable non-bankruptcy law.
37 The Bankruptcy Code requires that two-thirds in amount and more than one-half in number of a class of creditors vote to accept a plan for that class of creditors to be deemed to have accepted the plan. 11 USC, Section 1126(c).
39 The cases were In re FullBeauty Brands Holdings Corp., Case No. 19-22185 (Bankr. S.D.N.Y.) and In re Sungard Availability Services Capital Inc., Case No. 19-22915 (Bankr. S.D.N.Y.).
Active industries: oil and gas, power and retail

Filings by the oil and gas and energy industry, and retail and supermarket industry continued to dominate public company filings in 2018, comprising 22 per cent and 17 per cent of total filings, respectively. Three of the year’s 10 largest public filings came from the oil and gas and energy industry: FirstEnergy Solutions Corp, Aegean Marine Petroleum Network Inc and EV Energy Partners, LP. However, it is the retail industry that continues to dominate headlines.

Sears Holding Corporation was the second-largest public filing in 2018, with US$7.3 billion in pre-petition assets. Claire’s Stores, Southeastern Grocers, LLC and The Bon-Ton Stores Inc were also among the top 10 largest public company filings, while other notable filers included Tops Holding II Corp, Nine West, Mattress Firm, David’s Bridal, Brookstone, Rockport, Walking Company Holdings and Remington Outdoor. The trend has continued in the first quarter of 2019, with filings by Diesel, Charlotte Russe, FullBeauty Brands, Payless, and Gymboree, among others. Notably, this was the second Chapter 11 filing for Nine West, Brookstone, Payless and Gymboree, and the third for Southeastern Grocers. Toys R Us Inc, which filed for Chapter 11 protection in 2017, recognised it would not be able to restructure and commenced liquidation proceedings in 2018.

One notable bankruptcy filing was the Chapter 11 cases filed by Pacific Gas and Electric Company and its parent on 29 January 2019. PG&E, incorporated in 1905, is the biggest utility company in the United States and the largest energy company in California. There are approximately 24,000 employees who carry out PG&E’s primary business – the transmission and delivery of energy via natural gas and electric service – to approximately 16 million people throughout a 70,000-square-mile service area. As widely reported, California suffered several devastating wild fires in 2017 and 2018 that caused billions of dollars of property damage and injured and killed scores of people. PG&E may be liable for a substantial portion of the claims arising from the fires pursuant to the doctrine of ‘inverse condemnation’ (a strict liability theory applicable in California and a small number of other states) because its transmission lines and equipment may have been the originating source of some of the fires. Its bankruptcy filing was primarily motivated by a need to addresses these damage claims.

The PG&E bankruptcy is massive both in size and complexity. Upon the bankruptcy filing, California Governor Gavin Newsom stated: ‘My administration will continue working to ensure that Californians have access to safe, reliable and affordable service, that victims and employees are treated fairly, and that California continues to make forward progress on our climate change goals.’ This remains an interesting bankruptcy case to follow because of its complexity and the potential impact that public policy decisions will have on all of PG&E’s stakeholders and the citizens of California.

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41 The case is In re PG&E Corporation and Pacific Gas and Electric Company, Docket No. 19-30088 (N.D. Cal.)
iii Case law developments

Trademark and bankruptcy law at the Supreme Court

In *Mission Product Holdings, Inc v. Tempnology, LLC*, the US Supreme Court held that a debtor’s right to reject executory contracts pursuant to Section 365(a) of the Bankruptcy Code does not entitle a debtor to rescind trademark licenses. In so finding, the Court resolved a long-standing circuit split regarding whether the special protections granted to intellectual property (IP) licenses under Section 365(n) extend to trademark licenses.

As explained in Section II.ii, a debtor’s rejection of an executory contract under Section 365 of the Bankruptcy Code generally constitutes a breach of that contract, excusing the debtor from future performance and resulting in a claim for damages. In contrast, Section 365(n) of the Bankruptcy Code provides that an intellectual property licensee’s right to use a non-exclusive license cannot be unilaterally terminated upon the debtor’s decision to reject the licence. Instead, the licensee may elect to retain its rights under the license agreement for the remainder of the licence term. However, Congress deliberately excluded trademarks from the Bankruptcy Code’s definition of intellectual property, and courts have split regarding whether Section 365(n) applies to trademark licenses.

The debtor in *Mission Products, Tempnology*, licensed patents and trademarks for stay-cool sportswear fabric to Mission Products. The licence permitted either party to terminate for convenience, to be followed by a two-year wind-down period. Mission Products terminated the licence. Fifteen months later Tempnology filed for Chapter 11 protection and rejected the trademark licence held by Mission Products. The Court of Appeals for the First Circuit ruled that Section 365(n) did not apply and held the rejection of the trademark licence terminated Mission Product’s right to use the licensed marks.

In overturning the First Circuit’s decision, the Supreme Court ruled that ‘both section 365’s text and fundamental principles of bankruptcy law’ supported the conclusion that rejection of an executory licence – including a trademark licence – operates only as a breach, not as a rescission that would allow a debtor to unilaterally revoke an ongoing trademark licenses. The debtor may stop performing its obligations under the trademark licence, but the licensee is free to continue using the license pursuant to its terms. The decision brings welcome clarity to an area of the law that has long been unsettled.

Make wholes and impairment

In *In re Ultra Petroleum Corp* the Court of Appeals for the Fifth Circuit unequivocally concluded that a debtor’s plan of reorganisation does not impair a creditor by refusing to pay an amount the Bankruptcy Code independently disallows. Less emphatically, the court held that make whole amounts will generally, if not always, be considered unmatured interest.

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43 11 USC § 365(n).
44 11 USC § 101(35).
45 See, e.g., the seminal case in *Lubrizol Enters, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985) (the court held that rejection of an executory IP licence results in termination, a decision that prompted Congress to amend the Bankruptcy Code by adding section 365(n)), versus *Sunbeam Products Inc. v. Chicago American Manufacturing, LLC*, 686 F.3d 382 (7th Cir. 2012) (rejection of a trademark only terminates a debtor’s obligations under a trademark licence, not the licensee’s right to use the trademark pursuant to the terms of the license).
47 913 F.3d 522 (5th Cir. 2019).
The decision is a significant one for fixed-rate lending markets, because it means that debtors in the Fifth Circuit may be able to avoid paying make whole amounts without impairing a creditor’s claims.

Ultra Petroleum Corp and its subsidiaries (Ultra) were an oil and gas exploration and production company forced into bankruptcy by the catastrophic decline in oil and gas prices that occurred in 2015 and 2016. During the pendency of Ultra’s bankruptcy cases, oil prices rebounded and Ultra became solvent. One of the Ultra debtors was the borrower under several debt agreements, which provided that the debtor’s bankruptcy constituted an event of default requiring the payment of a contractual make whole amount and post-petition interest at contractual default rates. The debtors’ plan did not pay the make whole amount and proposed to pay post-petition interest at the (far lower) federal judgment rate. Nonetheless, the debtors claimed their proposed plan of reorganisation paid all creditors in full and impaired no one, because the portions of the creditors’ claims that were unpaid were specifically disallowed by the Bankruptcy Code. Hence it was the Bankruptcy Code, not the debtors’ plan, that impaired the creditors. Specifically, they argued the make whole amount constituted a claim for ‘unmatured interest’, disallowed under Section 502(b)(2) under the Bankruptcy Code, or it was an unenforceable liquidated damages provision under New York law. Similarly, the Bankruptcy Code only entitled the creditors to post-petition interest at the ‘legal rate’, as provided by Section 726(a)(5) of the Bankruptcy Code, which is the federal judgment rate under 28 USC Section 1961.

The bankruptcy court found that the plan’s failure to pay the creditors’ full claim rendered them impaired, regardless of whether the full amount of the creditors’ claim was allowed under the Bankruptcy Code. The court found that the make whole was an enforceable liquidated damages provision under New York contract law,48 and did not consider whether it constituted unmatured interest.

The Fifth Circuit vacated and remanded. The court characterised the question as ‘whether [a] rich man’s creditors are ‘impaired’ by a plan that paid them everything allowed under the Bankruptcy Code’.49 Where the bankruptcy court had answered that question with a ‘yes’,50 the Fifth Circuit disagreed. The court distinguished between ‘Bankruptcy Code impairment’ and ‘plan impairment’, concluding ‘[w]here a plan refuses to pay funds disallowed by the Bankruptcy Code, the Bankruptcy Code – not the plan – is doing the impairing.’51

The Fifth Circuit found that the make whole payment constituted unmatured interest under Section 502(b) of the Bankruptcy Code, because it was the ‘economic equivalent’ of interest (intended to compensate the lender for lost interest) and that it was ‘unmatured’ because it only became due as a result of the filing.52 Therefore, the debtors were not required to pay the make whole amount under the Bankruptcy Code. However, there was a possibility the debtors might be required to pay the make whole if, on remand, the bankruptcy court

49 913 F.3d at 537.
50 id.
51 id. at 542.
52 id. at 547-48.
determined that the pre-Bankruptcy Code rule requiring solvent debtors to pay post-petition interest at the contract rate survived the enactment of Section 502(b)(2). The Fifth Circuit expressed doubt that it did.\(^{53}\)

Finally, on the matter of the appropriate rate of post-petition interest, the Fifth Circuit determined that the creditors had no legal right to post-petition interest at the contract rate, because the Bankruptcy Code is silent regarding post-petition interest on unimpaired claims in Chapter 11 cases.\(^{54}\) The Fifth Circuit determined the appropriate rate was either the rate authorised by Section 726(a)(5) or some other rate supported by the equities of the case, and remanded the issue to the bankruptcy court to determine which should apply.\(^{55}\)

**Horizontal gifting**

The US District Court for the District of Delaware decision in *Hargreaves v. Nuverra Environmental Solutions Inc*\(^{56}\) adds some color to the law on the law of gifting in Delaware by distinguishing between ‘horizontal’ gifting and ‘vertical’ gifting.

The debtor, Nuverra, filed a prepackaged plan of reorganization pursuant to which secured creditors would exchange their debt for equity in the reorganised company. The secured creditors agreed to ‘gift’ payments to the unsecured creditor classes, who would otherwise receive no distribution under the plan. ‘Gifting’ occurs when a structurally senior class of creditors provides some recovery to a more junior class of claims or equity holders, in exchange for the more junior class’s support of a proposed plan or asset sale. Courts have been inconsistent in their approach to gifting. In many, but not all, cases it has been found to violate the absolute priority rule.

In *Hargreaves*, a class of unsecured noteholders were gifted a combination of new stock and cash amounting to a 4–6 per cent recovery, while a class of unsecured trade creditors were gifted full payment of their claims. The class of noteholders voted to reject the plan. A noteholder, David Hargreaves, objected to confirmation and to being crammed down under the plan on the grounds that the plan’s proposed treatment of the dissenting noteholder class discriminated unfairly against the class, in violation of the Bankruptcy Code’s cram-down laws, because it received less value under the plan than the unsecured trade creditor class. Hargreaves also objected to the separate classification of the noteholders and trade creditors.

The Bankruptcy Court for the District of Delaware confirmed the plan.

The District Court for the District of Delaware found the appeal was equitably moot, but held the confirmation order would have been affirmed for the reasons articulated by the bankruptcy court. In finding that the plan did not unfairly discriminate, the court distinguished between ‘vertical’ gifting – forbidden in the Third Circuit – and ‘horizontal gifting’ – which is not foreclosed under Third Circuit law. Vertical gifting occurs when a senior class gifts a recovery to a lower class, skipping an intermediate class of impaired creditors, so that the absolute priority rule is violated. This case involved horizontal gifting, where unequal gifts are given by a secured creditor to two similarly situated classes of junior creditors without implicating the absolute priority rule. The District Court concluded that the different gifts given to the noteholders and trade creditors gave rise to a rebuttal presumption of discrimination, but that the presumption was rebutted by the fact that the senior creditor

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\(^{53}\) id. at 549.

\(^{54}\) id at 547.

\(^{55}\) id at 550-51.

\(^{56}\) 590 B.R. 75 (D. Del. 2018).
had a good reason to satisfy fully the claims of the unsecured trade creditors, as they were critical to the success of the reorganised debtors. The importance of the trade creditors also led the bankruptcy court to conclude that the separate classification of the noteholders and trade creditors was reasonable.\textsuperscript{57} Hargreaves has been appealed to the Court of Appeals for the Third Circuit.

**Third-party releases**

In *Opt-Out Lenders v. Millennium Lab Holdings II, LLC (In re Millennium Lab Holdings II, LLC)*,\textsuperscript{58} the US District Court for the District of Delaware affirmed that the bankruptcy court had jurisdictional authority to grant non-consensual third-party releases as part of an order confirming a Chapter 11 plan, notwithstanding that the plan released racketeering claims against certain parties.

Third-party releases (the extinguishment of a non-debtor third party’s claim against a non-debtor third party, without consent of the releasing party) have been the subject of considerable judicial scrutiny and a topic of controversy among courts. Section 524(e) of the Bankruptcy Code provides that "discharge of a debt of the debtor does not affect the liability of any other entity on . . . such debt."\textsuperscript{59} However, courts in many (though not all) circuits have determined that third-party releases may be permissible under certain circumstances. The ability of bankruptcy courts to grant third-party releases was thrown into question by the decision of the Supreme Court in *Stern v. Marshall*,\textsuperscript{60} in which the court found that the United States Constitution forbids Article 1 judges — including bankruptcy court judges — to render decisions as courts of the United States. The court found that only Article 3 judges, such as those that sit on district courts, have that authority. Although Chief Justice John Roberts stated that *Stern* was a narrow decision that would not cause material changes to the administration of bankruptcy cases,\textsuperscript{61} the decision threw into question bankruptcy judges’ jurisdictional authority. Its reverberations continue to be felt today, as litigants and courts try to establish anew what powers and responsibilities bankruptcy courts possess, and where those powers and responsibilities are constrained by constitutional limits.

In *Millennium*, a group of creditors asserted that, under *Stern*, bankruptcy courts do not have the constitutional authority to grant third-party releases and a reorganisation plan that contains such a release may only be confirmed by an Article 3 court. The *Millennium* debtors’ proposed plan of reorganisation included US$325 million in plan funding provided by four equity holders, to be used, in part, to fund a settlement with federal regulators. The plan proposed to release the equity holders’ claims against the debtors and against non-consenting third parties. The creditors, who were asserting racketeering claims against the equity holders, argued that the bankruptcy court did not have subject matter jurisdiction to grant non-consensual third-party releases. They argued that the bankruptcy court had no authority to enter final judgment on the racketeering claims, and that the grant of non-consensual releases that released the creditors’ racketeering claims against the equity holders did precisely

\textsuperscript{57} In re Nuverra Environmental Solutions, Inc. No. 17-10949 (Bankr. D. Del.), July 24, 2017 Hrg Tr. at 5:5-6:24.  
\textsuperscript{58} 591 B.R. 559 (D. Del. 2018).  
\textsuperscript{59} 11 U.S.C. § 524(e).  
\textsuperscript{60} 564 U.S. 462 (2011).  
\textsuperscript{61} id. at 501.
that. The bankruptcy court found that it had jurisdiction to grant the third-party releases, because the ‘operative proceeding’ before the court was confirmation of the plan rather than litigation of the racketeering claims, and confirmed the plan.

The US District Court for the District of Delaware affirmed the bankruptcy court’s order confirming the plan. It agreed with the lower court that the ‘operative proceeding’ before the court was the confirmation of the Chapter 11 plan, not the litigation of the racketeering claims. Plan confirmation is an enumerated core proceeding, meaning, under *Stern*, the bankruptcy court had statutory authority to approve the third-party releases as part of the plan. The court quoted with approval the bankruptcy court’s conclusion that ‘[t]aking the position that third party releases in a plan are equivalent to [a constitutionally] impermissible adjudication of the litigation being released is, at best, a substantive argument against third party releases, not an argument that confirmation orders containing releases must [under *Stern*] be entered by a district court.’ The decision has been appealed to the Court of Appeals for the Third Circuit.

A few weeks after the *Millennium* decision, the US District Court for the Southern District of New York reached a similar conclusion in *Lynch v. Lapidem Ltd (In re Kirwan Offices SARL)*. The debtors’ plan of reorganisation included exculpation and injunction clauses that enjoined anyone from attempting to sue Lapidem in any other forum in connection with the events arising from Kirwan’s bankruptcy proceedings and reorganisation. The court, in approving the plan, concluded that ‘[a] bankruptcy court acts pursuant to its core jurisdiction when it considers the involuntary release of claims against a third-party, non-debtor in connection with the confirmation of a proposed plan of reorganization, which is a statutorily defined core proceeding.’

**Bankruptcy blocking provisions**

In *Franchise Services of North America, Inc v. Macquarie Capital (USA), Inc (In re Franchise Services of North America, Inc)*, the Court of Appeals for the Fifth Circuit affirmed the bankruptcy court’s order dismissing as unauthorised a bankruptcy filing made by a debtor without the consent of its sole preferred equity holder, who held a blocking position enabling it to prevent a bankruptcy filing. The court found that neither federal law nor Delaware corporate law prevented the equity holder from exercising its blocking position, and that without the preferred equity holder’s consent the filing was invalid.

Macquarie Capital (USA) (Macquarie) made a US$15 million preferred equity investment, via an investment vehicle, in Franchise Services of North America (FSNA), making it FSNA’s single largest equity holder. In exchange for the investment, FSNA agreed to reincorporate in Delaware and for its certificate of incorporation to incorporate a blocking provision, which specified that the consent of a majority of each class of the debtor’s common and preferred shareholders was required to ‘effect any liquidation event.’ This blocking

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62 591 B.R. at 575.
63 id. at 576-77.
65 id. at 499.
66 id. at 504.
67 891 F.3d 198 (5th Cir. 2018).
position meant Macquarie could prevent a voluntary bankruptcy filing by the company by withholding consent. Separately, FSNA owed Macquarie US$3 million in advisory fees in connection with the transaction.

FSNA filed for Chapter 11 protection without obtaining Macquarie’s consent. Macquarie challenged the filing as *ultra vires*. FSNA argued that the blocking position was invalid as contrary to public policy because Macquarie was a creditor and not a bona fide equity owner. The bankruptcy court flatly rejected this argument, and the appeal was certified to the Court of Appeals for the Fifth Circuit.

The Court of Appeals was presented with three broad questions: (1) whether a blocking provision or golden share that gives a party the ability to prevent a corporation from filing from bankruptcy is valid, or contrary to federal public policy; (2) whether such a provision can be exercised by an entity that is both a creditor and an equity holder of the debtor; and (3) under Delaware law, whether a certificate of incorporation contains a blocking provision, and if so, whether the holder of the provision has a fiduciary duty to exercise it in the best interests of the corporation. The court declined to answer these broad questions and instead limited its analysis to the narrow facts of the case, finding that nothing in federal or Delaware law prevents the amendment of a corporate charter to allow a non-fiduciary shareholder, fully controlled by an unsecured creditor, to prevent a voluntary bankruptcy petition.68 The fact that a bona fide equity shareholder is also an unsecured creditor does not prevent it from exercising its right to vote against a bankruptcy petition. The court emphasised that it was not presented with a case where a creditor had somehow contracted for the right to prevent a bankruptcy, or where the equity interest was a ruse,69 suggesting a different outcome would be possible – or even likely – on those facts.

### IV INTERNATIONAL

#### i Background on Chapter 15

In 2005, Congress added Chapter 15 to the Bankruptcy Code. Chapter 15 ‘incorporates the Model Law on Cross-Border Insolvency to encourage cooperation between the United States and foreign countries with respect to transnational insolvency cases’.70 Chapter 15 is based on a ‘rigid recognition standard’ that one court labelled ‘consistent with the general goals of the Model Law’.71 Thus, if a US bankruptcy court denies recognition of a foreign proceeding, Section 1509(d) of the Bankruptcy Code provides that ‘the court may issue any appropriate order necessary to prevent the foreign representative from obtaining comity or cooperation from courts in the United States’.72 ‘This has been interpreted to mean that Chapter 15 recognition is now the sole form of relief in the United States with respect to foreign insolvency proceedings.73

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68 id. at 203, fn. 1.
69 id. at 207-08.
72 11 USC, Section 1504.
73 *See Iida v. Kitahara (In re Iida)*, 377 BR 243, 257 n21 (BAP 9th Cir 2007) (‘Subsections (b)(2), (b)(3), and (c) [of Section 1509] make it clear that Chapter 15 is intended to be the exclusive door to ancillary assistance to foreign proceedings’).
A foreign representative can obtain recognition under Chapter 15 of the Bankruptcy Code ‘by the filing of a petition for recognition of a foreign proceeding under Section 1515’,\(^74\)

Two types of recognition of a foreign proceeding are possible under Chapter 15: recognition as a foreign main proceeding or recognition as a foreign non-main proceeding. Greater relief is available to a foreign representative of a foreign main proceeding than for a representative of a foreign non-main proceeding.

In order for a US court to recognise a foreign proceeding as a main proceeding, the foreign proceeding must be ‘pending in the country where the debtor has the centre of its main interests’,\(^75\) (COMI). COMI is not defined in Chapter 15. Section 1516(c), however, sets out a presumption that the debtor’s registered office is the COMI ‘[i]n the absence of evidence to the contrary’.\(^76\) Moreover, one of the first bankruptcy decisions to analyse the matter defined a company’s COMI as a debtor’s ‘principal place of business’ under concepts of United States law’.\(^77\) Indeed, the concept of COMI is lifted from the EU Regulation, which defines COMI as ‘the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties’.\(^78\) On the other hand, the Second Circuit has rejected the notion that ‘principal place of business’ analysis should be used,\(^79\) but did note that the concept is still useful in determining the factors that point to a COMI. The court went on to say that ‘any relevant activities, including liquidation activities and administrative functions, may be considered in the COMI analysis’.\(^80\)

The Second Circuit also provided more guidance in determining the relevant period to examine in establishing a debtor’s COMI, concluding that the relevant analysis should be based on the debtor’s activities at or around the time the Chapter 15 petition is filed [...but] that a court may consider the period between the commencement of the foreign insolvency proceeding and the filing of the Chapter 15 petition to ensure that a debtor has not manipulated its COMI in bad faith’.\(^81\)

Lacking the required COMI, a foreign proceeding may be recognised as a non-main proceeding under Chapter 15 if the foreign proceeding is ‘pending in a country where the debtor has an establishment’.\(^82\) ‘Establishment’ is defined in Chapter 15 as ‘any place of operations where the debtor carries out a nontransitory economic activity’.\(^83\)

\(^74\) 11 USC, Section 1504.
\(^75\) 11 USC, Section 1502(4).
\(^76\) 11 USC, Section 1516(c).
\(^77\) *In re Tri-Continental Exch Ltd*, 349 BR 627, 629 (Bankr. ED Cal 2006).
\(^79\) *Morning Mist Holdings Ltd v. Keys (In re Fairfield Sentry Ltd)*, Case No. 11-4376, 2013 WL 1593348, at *6 (2nd Cir 2013).
\(^80\) id. at *8.
\(^81\) See id. at *8.
\(^82\) 11 USC, Section 1502(5).
\(^83\) id. Section 1502(2).
whether a debtor has an establishment in the foreign proceeding jurisdiction ‘is essentially a factual question, with no presumption in its favour’. At least one court has held that non-main recognition is restricted to a jurisdiction in which a debtor has assets.

The year 2018 saw 100 Chapter 15 filings, up from 86 in 2017.

ii  Case law developments: extraterritoriality and avoidance law

As discussed in Section II.iv, a debtor or trustee’s ability to recover estate funds via the use of avoidance actions is a powerful tool in bankruptcy. However, the law on the extraterritorial application of the Bankruptcy Code’s avoidance action provisions is unsettled, even as cross-border bankruptcy cases implicating those provisions become more common.

There is a general presumption against extraterritorial application of US law, ‘that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States’. In the Southern District of New York, the issue of whether Congress intended for the Bankruptcy Code’s avoidance action provisions to apply extraterritorially is particularly vexed, with courts in the same district reaching conflicting decisions. Some, such as the bankruptcy court in the recent case In re CIL Limited, conclude that ‘nothing in the language of Sections 544, 548 and 550 of the Bankruptcy Code suggests that Congress intended those provisions to apply to foreign transfers.’ Other courts point to Congress’s definition of ‘property of the estate’ in Section 541 of the Bankruptcy Code, which includes all the debtor’s property ‘wherever located and by whomever held’, as evidence that Congress did not intend to exclude extraterritorial transfers from the ambit of the Bankruptcy Code’s avoidance actions.

The Court of Appeals for the Second Circuit had the opportunity to resolve this issue in In Re Picard, Trustee for Liquidation of Bernard L. Madoff Investment Securities LLC, but declined to do so. Nonetheless, the court introduced some welcome clarity to the law by demonstrating that the presumption against extraterritoriality may not be a bar to recovering property fraudulently transferred abroad, so long as the initial fraudulent transfer is rooted in the United States. Looking closely at the language of Section 548(a)(1), the court noted the Section ‘allows a trustee to ‘avoid any transfer . . . of an interest of the debtor in property . . . made . . . with actual intent to hinder, delay or defraud’. The language of the Section focuses on the initial transfer, leading the court to conclude that ‘when a trustee seeks to recover subsequently transferred property under section 550(a), the only transfer that must

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84 In re Bear Stearns, 389 BR at 338.
85 id. at 339 (‘In general, Section 1521(c) of the Bankruptcy Code limits the scope of relief available in a nonmain proceeding to relief related to assets located in the nonmain jurisdiction or closely connected thereto, while a plenary bankruptcy proceeding where the [debtors] are located would control the [debtors’] principal assets’).
88 LaMonica v. CEVA Group PLC (In re CIL Ltd.), 582 B.R. 46, 84-85 (Bankr. S.D.N.Y. 2018).
91 917 F.3d 85 (2019).
92 id. at 97.
be avoided is the debtor’s initial transfer.”\(^{93}\) Hence, so long as the initial transfer of property constitutes domestic activity, the fraudulently transferred property may be traced to its ultimate transferee, wherever located, and recovered.

In a similar vein, the Bankruptcy Court for the Southern District of New York found in *Fairfield Sentry Ltd v. Amsterdam (In re Fairfield Sentry Ltd)*,\(^ {94}\) that the safe harbour provisions in Section 546(e) of the Bankruptcy Code, (which shield certain transferees from avoidance actions) apply extraterritorially, through the operation of Section 561(d) of the Bankruptcy Code. Section 561(d) specifically provides that the Bankruptcy Code’s safe harbours ‘apply in a case under chapter 15 . . . to limit avoidance powers to the same extent as in a proceeding under chapter 7 or 11 of this title’.\(^ {95}\) Hence, the safe harbour was a valid defence to ‘proceedings brought by foreign representatives in a chapter 15 case seeking to avoid purely foreign transfers under foreign insolvency laws’.\(^ {96}\)

\(^{93}\) id. at 98.


\(^{95}\) 11 U.S.C. § 561(d).

\(^{96}\) 596 B.R. 275 at 310.
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He regularly collaborates on structuring transactions to address potential litigation and insolvency issues. Recent work includes loan-to-own transactions and cross-border rescue financings, to tackle new money privileges, as well as clawback and automatic stay risks.

As a litigator, Mr Ara also has experience in security interests, directors’ fiduciary duties and corporate and M&A-related disputes.
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Selin Barlin Aral is the partner at Paksoy who specialises in corporate, mergers and acquisitions, real estate and commercial law matters. Ms Barlin Aral has extensively advised clients in financial services, food and beverages, manufacturing, retail, pharmaceutical and media for cross-border acquisitions, international joint ventures and for their day-to-day corporate and commercial activities, including corporate maintenance work and contract drafting. She has acted for sellers, strategic buyers and PE clients in M&A projects and has substantial experience in capital venture investments. Her practice also focuses on the healthcare and pharmaceutical industries, particularly joint venture investments in public procurements. She advises sponsors and investors on a wide range of real estate projects including residential and commercial developments, hospitality investments and data centre operations and assists in their legal day-to-day requirements. Ms Barlin Aral also advises clients in restructuring and insolvency matters, especially in corporate restructurings.

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Sébastien Binard is a partner in the private equity and real estate, corporate law, mergers and acquisitions, and commercial and insolvency practices of Arendt & Medernach. He specialises mainly in corporate law, mergers and acquisitions, private equity transactions, restructuring and insolvency matters.

He advises major private equity firms and alternative fund managers on the structuring and financing of cross-border buy-out transactions and private investments, the formation of joint venture companies and private investment vehicles, corporate restructurings, exit strategies, corporate governance matters and shareholder relations.

He also represents institutional investors acting as shareholders or creditors of companies experiencing financial difficulties (whether solvent or insolvent) as well as such companies, including in relation to financial restructurings, COMI shifts, distressed business transactions, cross-border reorganisations and insolvency proceedings.

Sébastien regularly speaks at seminars and conferences on his areas of expertise. He is a member of the legal committee and of the market intelligence committee of the Luxembourg Private Equity and Venture Capital Association (LPEA) and a member of the Business Law Commission of the Board of the Luxembourg Bar.

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Peter Bowden is a partner in Gilbert + Tobin’s restructuring and insolvency group. Mr Bowden specialises in front-end restructuring and insolvency. He has significant experience advising hedge funds, banks, special situations groups, investment banks, insolvency practitioners,
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Mr Bowden is admitted to practise in both Australia and the UK. He also gained significant international experience while working in Tokyo for a leading global law firm during 2008 and 2009. Prior to joining Gilbert + Tobin, he was a partner of a global law firm where he focused on front-end restructuring, insolvency and distressed debt.

Mr Bowden is listed in Best Lawyers in 2017 and 2018 in insolvency and reorganisation law. He was also named as a rising star in Doyle’s Guide in 2015 in insolvency and reconstruction. Mr Bowden is a member of the Australian Restructuring Insolvency and Turnaround Association and the Turnaround Management Association (TMA) and is on the VIC TMA Committee. Recently, Mr Bowden has worked on a number of prominent restructuring and insolvency matters including Toys R Us, Norske Skog, Mirabela Nickel, Nexus Energy, Arrium, LM First Mortgage Income Fund, Acquire Learning, Northern Energy/Colton Coal, Blue Sky Investments, Banksia Secured Investments, Timbercorp and Eastmark/One Denison.

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Barry heads the market-leading insolvency and corporate recovery team at Beauchamps in Dublin, where he advises a wide range of clients on contentious and non-contentious restructuring, insolvency and corporate recovery issues.

Barry is a Fellow of INSOL International and a member of the council for INSOL Europe, where he is also part of the Brexit group.

In addition, Barry stands appointed by the Irish Minister for Business, Enterprise and Innovation as a member of the statutory Company Law Review Group (CLRG) where he represents the Irish Society of Insolvency Practitioners. He chairs the CLRG’s corporate insolvency committee, which has recently published a report recommending the adoption of the UNCITRAL Model Law on Cross-Border Insolvency.

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Ms Del Prete is a legal advisor for major Italian and international corporations and private equity funds for Italian investments.

After graduating in law *magna cum laude* at the University of Rome in 1989, she attended a specialisation course on international business law at the University of Paris from 1992 to 1993.

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Philippe Dubois has considerable experience in restructuring and insolvency. He advises banking and financial institutions as well as large French and foreign industrial groups in a wide range of economic sectors. His practice focuses on restructuring, litigation and arbitration in diverse areas such as shareholder disputes, indemnification agreements and liabilities. He manages the firm’s restructuring and insolvency, dispute resolution and arbitration teams.


Philippe Dubois is recognised as ‘Lawyer of the Year’ in restructuring by *Option Droit & Affaires* magazine (2015).

Recent transactions include: Thomson-Technicolor (advising Thomson-Technicolor on the restructuring of the group); Ascométal (advising a group of French and European investors in connection with their successful takeover bid for Ascométal group, which was approved by the Commercial Court of Nanterre); Vivarte (representing a group of lenders); Camaïeu (representing a group of lenders in the context of its court-approved restructuring agreement); Financière Turenne Lafayette, holding company of William Saurin (representing the biggest group of lenders in the context of its sale plan) and Bourbon (representing a group of senior lenders – ongoing).

**DOMINIC EMMETT**

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Dominic Emmett heads the restructuring and insolvency group at Gilbert + Tobin and brings nearly 30 years of significant local and international experience.

Mr Emmett specialises in non-contentious restructuring and insolvency work for banks and financial institutions, as well as special situation groups and distressed debt funds. His expertise includes preparing and negotiating standstill and forbearance arrangements; debt restructuring and schemes of arrangement; structured administration and receivership sales; and advice to directors, receivers, administrators and liquidators. Recently, he has led the Gilbert + Tobin team working at the heart of Australia’s major restructuring: *Bis Industries, Slater and Gordon, Ten Network, Toys R Us, Norske Skog, Emeco, Boart Longyear, Arrium, Blue Sky Investments* and *Paladin*.

Mr Emmett has been consistently ranked as one of Australia’s elite restructuring and insolvency lawyers in all major legal directories for restructuring and insolvency. *Chambers*
Asia-Pacific 2018 recognises him as a star individual for restructuring and insolvency. Who’s Who Legal 2018 recognises Mr Emmett as the leading restructuring and insolvency lawyer in the world (excluding the US and Europe). The Finance Monthly Fintech Awards 2018 recognised him as banking and finance – lawyer of the year – Australia, and Legal 500 Asia Pacific 2018 ranks him as a leading lawyer for restructuring and insolvency among many others.

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Heinrich Foglar-Deinhardstein (born 1978) is a partner at Cerha Hempel Spiegelfeld Hlawati Rechtsanwälte GmbH with its headquarters in Vienna and several offices in CEE.

He studied law in Austria (Mag iur in 2002) and at King’s College in London (LLM 2005).

Heinrich Foglar-Deinhardstein was admitted to the Bar in Austria in 2009 and became a partner at Cerha Hempel in 2013. He specialises in corporate law, insolvency and restructuring, cross-border M&A, corporate acquisitions, takeovers, squeeze-outs and foundations as well as restructurings and reorganisations.

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Admitted to the Paris Bar in 2002, she graduated from HEC Paris (2000) and holds an advanced degree (DES) in tax and business law from the University of Paris I Panthéon-Sorbonne (2000). She joined De Pardieu Brocas Maffei’s restructuring and insolvency team in 2002. She was appointed counsel in 2009, before being made partner in 2014.

Joanna is also recognised by Who’s Who Legal: Restructuring & Insolvency 2016 and by the 2017 edition of Best Lawyers as ‘Lawyer of the Year’ in restructuring.

Recent transactions include: Conforama (representing the new money provider), Toys R Us (representing the French companies), CGG (representing the senior secured creditors’ committee); Foraco (representing the new money providers in the context of its court-approved restructuring) and Nextiraone (representing one of the largest creditors in the context of the first French pre-packaged sale plan and debt restructuring at the level of the holding company).

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Mr Heather has more than 40 years of experience in banking, restructuring, and mergers and acquisitions. Prior to returning to his current position as a result of the merger of Heather & Heather into Ritch, Mueller, Heather y Nicolau, SC, he was a partner at a leading US firm, where he headed the Latin American insolvency and restructuring group, and Ritch, Heather y Mueller in Mexico City, where he was the managing partner. In Mexico and the US, Mr Heather has published many articles and reviews on legal and financial topics, and has co-authored the treatise Regulation of Foreign Banks, among other publications. He is a board member of several leading corporations and Mexico’s second-largest bank. Mr Heather is a founding member of the International Insolvency Institute, an international fellow of American College of Bankruptcy and was a member of the Mexican Institute of Insolvency Specialists (IFECOM). He founded the Mexican Mediation Institute. Mr Heather has acted as a conciliator in 20 cases (including in the Empresas ICA case), and as a liquidator or receiver, in addition to his role as lead counsel in hundreds of consensual restructurings. He has lectured extensively and is a member of the Advisory Board of the Programme on International Financial Institutions of Harvard University.

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Fernando wrote many articles in the matters of his specialisation and is a member of the American Bar Association, the INSOL International’s Latin American Committee and the International Insolvency Institute; and he has participated as speaker and panellist in many seminars on the matters of his specialisations.

Fernando is recommended for Bankruptcy/Restructuring in Chambers Latin America (Band 3). The 2017 edition quotes clients who highlighted that he is ‘a highly qualified,
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J Eric Ivester represents clients including borrowers, creditors, investors, sellers, purchasers and other parties of interest at all stages of complex restructuring transactions, such as in-court and out-of-court reorganisations, debt restructurings, acquisitions and divestitures.

Mr Ivester’s recent representations include SunEdison, Inc in its Chapter 11 filing (the largest in 2016) and its successful emergence from Chapter 11, Exide Technologies in its emergence from its voluntary Chapter 11 case and confirmation of its plan of reorganisation resulting in the reduction of US$600 million of debt, Travelport Limited and related companies in their out-of-court restructurings of US$2.1 billion of debt, and MF Global Holdings Ltd in its Chapter 11 filing. Mr Ivester also represented Ipsen Pharma SA in the Chapter 11 case of Inspiration Biopharmaceuticals Inc, wherein Inspiration and Ipsen successfully consummated sales of two haemophilia drugs and related assets to Baxter International and Cangene Corporation.

Mr Ivester also led Skadden’s representations in the successful restructurings of Hostess Brands, then the maker of Wonder Bread and Twinkies and the nation’s largest wholesale distributor of fresh baked bread and sweet goods; Hayes-Lemmerz, the largest global producer of wheels for passenger cars and light trucks; and Mark IV/Dacco Products, a tier-one automotive supplier. In the retail sector, Mr Ivester was one of the partners that led the firm’s representation of Kmart Corporation and its affiliates in their successful emergence from Chapter 11. The Turnaround Management Association recognised Mr Ivester for his work on the Hostess Brands Chapter 11 case, naming it the large company transaction of the year at its 2009 Transaction of the Year Awards. In February 2009, Mr Ivester was named dealmaker of the week by The Am Law Daily for his work on the same case. Mr Ivester was named one of Turnarounds & Workouts’ outstanding restructuring lawyers in 2017, has been named in Lawdragon’s 500 Leading Lawyers in America and repeatedly has been selected for inclusion in Chambers Global and Chambers USA: America’s Leading Lawyers for Business, The Best Lawyers in America, IFLR1000 and Euromoney and Legal Media Group’s Expert Guide to the World’s Leading Insolvency and Restructuring Lawyers. Mr Ivester is a fellow of The American College of Bankruptcy.

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He has also advised on complex debt restructuring and refinancing deals at pre-insolvency stages (including the Spanish schemes and judicial homologation cases) and participated in several transactions advising international investors in the acquisition of distressed debt and non-performing loans portfolios (both secured and unsecured). He was directly involved in the incorporation of the Spanish bad bank (Sareb) and its transfer of impaired assets (€51 billion). More recently, he has regularly participated in bidding processes of loan portfolios on the buyer’s side and debt-for-equity and debt-for-assets situations.

From 1999 to 2000, he was an international associate in the banking group of Simpson Thacher & Bartlett in New York. From 2006 to 2008, he was based at Cuatrecasas’ London office, where he was responsible for the finance practice.

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Chris Mallon is a retired partner at Skadden, Arps, Slate, Meagher & Flom (UK) LLP who led and played a leading role in growing the firm’s corporate restructuring practice in Europe. He worked closely with the London finance, corporate M&A and private equity teams, and the US corporate restructuring group.

Mr Mallon’s restructuring and insolvency credentials span cross-border reorganisations involving a number of jurisdictions, including England, the United States, Ireland, India, Russia, the Cayman Islands, Bermuda, Poland, Germany, the Netherlands, Italy and Luxembourg. His clients included Enron, Global Crossing, WorldCom, Loral, Telewest, Parmalat, Eurotunnel, Gate Gourmet, British Vita, the Tele Columbus Group, TORM A/S, Danaos Corporation and Excel Maritime Carriers.

Mr Mallon acted for the Tele Columbus Group in restructuring its debt by means of a debt transfer and debt-for-equity swap implemented via several schemes of arrangement; for Calyon in relation to ongoing negotiations with FGIC regarding settlement of transactions relating to the Rhineland Conduit; for Carlyle in relation to Carlyle Capital Corporation Limited’s restructuring and renegotiation of its credit lines; and Residential Capital LLC in connection with its financial restructuring. He advised British Vita in relation to the restructuring of complex debt facilities for its operating companies, as well as various clients regarding their distressed investments arising in relation to the US Chapter 11 filing of Lehman Brothers. He advised other lenders with structured investment vehicles on issues arising out of the recent credit crisis in the subprime and related structured investment markets. He also advised TORM A/S in connection with its financial restructuring, reducing
its debt from US$1.4 billion to US$561 million, and involving third-party investor Oaktree Capital in contributing a number of vessels to the restructured TORM entity in return for an equity interest. He further advised Danaos Corporation, a Greek-based shipping company, in respect of its out-of-court refinancing of approximately US$ 2.2 billion of secured debt spread over 13 term loan facilities, resulting in a reduction of the company's outstanding debt by approximately US$ 551 million and retention by existing equity holders of a greater than 50 per cent shareholding interest.

Mr Mallon has repeatedly been selected for inclusion in Chambers Global: The World's Leading Lawyers for Business.

Mr Mallon writes and speaks frequently on insolvency and restructuring. After graduating from the University of Western Australia, he was admitted as a barrister and solicitor of the Supreme Court of Western Australia in 1982 and as a solicitor in England in 1987.

CLARA MARA-MARHUENDA
Arendt & Medernach

Clara Mara-Marhuenda is a partner in the litigation and dispute resolution, and commercial and insolvency practices of Arendt & Medernach.

She specialises in civil and commercial law focusing on corporate and finance disputes, asset tracing, arbitration and mediation as well as insolvency and restructuring.

Clara has been a member of the Luxembourg Bar since 2003. Prior to joining the Luxembourg Bar, she worked as an in-house counsel in Paris from 1999 to 2002.

She has been president of the Luxembourg National Committee of the International Association of Lawyers since November 2018.

Clara holds a master’s degree in business law and a diploma of specialised studies in industrial property law from the Université Paris II Panthéon - Assas (France), as well as an LLM from the Ludwig-Maximilians-Universität of Munich, Germany.

MARK MEILI
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Mark Meili is a member of Prager Dreifuss’ corporate and M&A and dispute resolution teams. He mainly advises companies with regard to commercial and corporate law matters. His main areas of practice include mergers and acquisitions, corporate finance as well as contract, corporate and commercial law matters. Mark Meili further advises clients in matters of insolvency and restructuring law. In these fields he also represents clients in court and before arbitration tribunals.

GRÉGORY MINNE
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Grégory Minne is a partner in the banking and financial services, the bank lending and structured finance, and the commercial and insolvency practices of Arendt & Medernach. He specialises in banking and finance, in particular in acquisition, fund, real estate, project, aircraft, rail, ship, and structured finance, securities transactions, payment and securities settlement systems, refinancing, restructuring and insolvency. He also advises clients on
complex private international law matters and on the legal enforceability of set-off, netting and collateral arrangements with respect to cross-border transactions and related insolvency risks and regulatory requirements.

He has been a member of the Luxembourg Bar since 2005.

Prior to joining Arendt & Medernach, Grégory worked in Switzerland within the legal department of a leading French investment bank.

He is a conferee of the Conference of European Restructuring and Insolvency Law (CERIL), and a member of INSOL Europe and the European Law Institute (ELI).

He is a lecturer at the University of Luxembourg and a visiting lecturer at the Catholic University of Louvain (Belgium), at the University of Paris Est Créteil (UPEC, Paris XII) (France) and at the University of Strasbourg (France), and is a frequent speaker at conferences and seminars. Grégory Minne is the author of numerous articles on issues related to his areas of expertise. He is also a recipient of the prize awarded by the Luxembourg Association of Banking Law Lawyers (ALJB, Association Luxembourgeoise des Juristes de Droit Bancaire) for his study on the conflict of laws rules concerning set-off and netting in the financial sector.

Grégory holds a master’s degree in law from the Catholic University of Louvain (Belgium) and a master’s in business law from the Universities of Geneva and Lausanne (Switzerland). He also holds a degree in philosophy from the Catholic University of Louvain (Belgium) as well as a degree in economic and social ethics from the same university.

In the Legal 500 2017 guide, he is considered by clients as a ‘key figure’ of the banking and finance sector, and ‘well versed in cross-border financings’. He was mentioned as a ‘rising star’ in IFLR1000 2017.

He speaks English and French, and has a reading knowledge of Dutch and Italian.

PIYUSH MISHRA
AZB & Partners

Piyush Mishra has been a partner with AZB & Partners since 2018. Prior to joining AZB, he was a partner in Cyril Amarchand Mangaldas and L&L Partners. He has extensive experience in financing, insolvency and in dealing with distressed assets. He is admitted to practise in India and is a solicitor (non-practising) of England and Wales. He is recognised as a leading lawyer by international publications including IFLR 1000.

MICHAEL NOWINA
Baker & McKenzie LLP

Michael Nowina is a partner who practises in the areas of commercial law and insolvency law. He acts for unsecured creditors, secured creditors, debtors, receivers, trustees-in-bankruptcy and court-appointed officers, purchasers of distressed assets, equity investors and financiers in insolvency and restructuring proceedings. Michael has extensive experience in employment and pension law issues arising from corporate liquidations or restructurings.

TOM PUGH
Mayer Brown

Tom Pugh is a partner in Mayer Brown’s restructuring, bankruptcy and insolvency practice, focusing on advising insolvency practitioners, creditors and debtors in respect of cross-border insolvencies and restructurings. His experience includes multibank work-outs; schemes of
arrangement; distressed debt and asset trading; and large-scale liquidations and restructurings, such as Lehman Brothers and MF Global, acting for the liquidators in Hong Kong and Chapter 11 cases, such as Pacific Andes. Tom’s restructuring and liquidation work has involved advising on cross-border asset recoveries and settlements; court processes to resolve key issues affecting liquidators’ ability to determine and distribute assets; matters arising on administration of failed brokerages; and assignments involving the PRC, Thailand, Vietnam, the Philippines, the United States, the United Kingdom, Germany, Switzerland and Japan. Mr Pugh is admitted as a solicitor in Hong Kong and England and Wales. He is a board member of the Hong Kong chapter of the global Turnaround Management Association.

IÑIGO RUBIO LASARTE
Cuatrecasas

Mr Rubio is a partner who specialises in advising on the financing of infrastructure projects (public private partnerships and private finance initiatives) and real estate projects, whether simple, syndicated or structured (e.g., sale-and-leaseback and off-balance-sheet transactions).

He also has ample experience in corporate and asset finance, and debt restructuring transactions, having participated in several of the most important and complex refinancing processes of recent years. Recently, Mr Rubio has been involved in advising institutional investors in their acquisition of NPL portfolios from the Spanish financial entities. Since joining Cuatrecasas, Gonçalves Pereira in 2000, Mr Rubio has developed most of his career in the firm’s offices in Madrid and then London, where he was managing partner between 2010 and 2013.

Recommended by several directories, including Chambers Europe, Chambers Global, Best Lawyers and The Legal 500 in real estate and corporate and M&A, banking and finance, project finance (Spain and the UK) and public finance.

ANNA RYAN
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Anna Ryan is a senior lawyer in Gilbert + Tobin’s restructuring and insolvency group. Mrs Ryan specialises in both contentious and non-contentious restructuring and insolvency. She has over 10 years’ experience advising banks, special situations groups, insolvency practitioners, creditors and debtors on restructuring, insolvency, workouts, and distressed debt transactions.

Prior to joining Gilbert + Tobin, she held various in-house roles at one of Australia’s major banks, where she focused on distressed debt, restructuring, workouts and insolvency. Mrs Ryan’s expertise includes preparation of forbearance and restructuring documentation, including DOCAs, advising on all aspect of security enforcement and the Personal Property Securities Act 2009 (Cth), and acting for liquidators in public examinations of directors and officers.

Mrs Ryan is a member of the Australian Restructuring Insolvency and Turnaround Association and the Turnaround Management Association (TMA). Recently, she has worked on a number of prominent restructuring and insolvency matters in the Australian market including Slater and Gordon, Ten Network, Toys R Us, Arrium, Paladin, Northern Energy/Colton Coal, Blue Sky Investments and Acquire Learning.
DOROTHEOS SAMOLADAS
Sarantitis Law Firm

Dorotheos Samoladas is a partner of the firm and head of its corporate practice. Moreover, he is a graduate of the Faculty of Law of the University of Athens and has also completed postgraduate studies in the UK (LLM Soton).

Dorotheos Samoladas has extensive experience and a wide-ranging, successful practice in corporate, M&A, restructuring and commercial law. He advises on mergers and acquisitions (including leveraged buyouts, private equity and public takeovers), leads an active restructuring practice and also advises on joint ventures, IPOs, privatisations, commercial contracts, regulatory compliance, as well as an active commercial litigation practice. Dorotheos Samoladas has been involved in high-profile litigation cases before the Greek courts in the past 12 years. His litigation practice also includes representing mainly corporate clients before the Greek administrative courts, in various types of administrative disputes. Dorotheos Samoladas has acted for public and private companies, some of Greece’s leading business figures, as well as large multinational corporate clients, banks and high net worth individuals. He has also represented various parties before independent supervising authorities and in government investigations.

According to BestLawyers.com, Dorotheos Samoladas was selected by his peers as lawyer of the year 2014 for Athens, in the practice area of mergers and acquisitions, and he won the Chambers Award 2015 in the practice area of corporate and commercial.

He is a member of the Athens Bar and the International Bar Association. He speaks English and French proficiently.

ALISSA SCARCELLO
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Alissa Scarcello is a summer associate at Baker McKenzie’s Toronto office. She is currently completing her studies obtaining a dual Canadian and American juris doctor degree at the University of Windsor Faculty of Law and the University of Detroit Mercy School of Law.

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Brittany Shales is a summer associate at Baker McKenzie’s Toronto office. She has a master of arts degree in international relations from Queen’s University and is currently completing her studies obtaining a juris doctor degree at the University of Calgary Faculty of Law.

 SERA SOMAY
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Sera Somay is the partner heading the banking and finance practice of the firm. Ms Somay works on financing transactions, representing lenders and borrowers including club loans, syndicated loans, regulatory capital, ECA covered loans, acquisition financing, various forms of secured financing and other structured financings. She has a specific focus on Islamic finance transactions and advised on the first international sukuk issuance by the Republic of
Turkey and the first sukuk issuance by a Turkish Islamic bank. She also works on murabaha syndications of Turkish participation banks and Turkish corporates. Ms Somay also advises on regulatory M&As across a variety of sectors with a focus on banking M&As.

ILYA SOROKIN
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Ilya Sorokin is counsel specialising in dispute resolution and insolvency. Ilya has been counsel in a number of high-profile arbitrations and bankruptcies involving multiple jurisdictions. In recent years, his experience has focused on disputes in financial and banking sectors.

MARTIN TASMA
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Dr Martin Tasma is a partner at Hengeler Mueller. He is based in Berlin and previously spent time in the Frankfurt and London offices of the firm. Martin advises corporate clients as well as private equity funds and other financial investors on debt and equity restructurings, distressed M&A transactions and financings. In distressed situations, he advises shareholders, lenders, borrowers as well as investors, including distressed debt investors and providers of rescue finance. Martin’s practice also covers formal insolvency proceedings. Prior to joining Hengeler Mueller, Martin spent time in the financial restructuring group of a US investment bank.

THOMAS TRETNAK
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Dr Thomas Trettnak (born 1976) is a partner at Cerha Hempel Spiegelfeld Hlawati Rechtsanwälte GmbH with its headquarters in Vienna and several offices in CEE. He heads the CEE insolvency and restructuring practice and is a member of the corporate and M&A practice.

He studied law and business in Austria, Spain and the United States (Mag et Dr iur, LLM) and has a master’s degree in Business Administration from the Kellogg School of Management (CM).

Dr Trettnak is admitted as an attorney in Austria and in New York, and became a partner at Cerha Hempel in 2010. He advises domestic and international clients mainly in (cross-border) M&A, restructuring and insolvency cases, venture capital and private equity transactions.

MARIA-FERENIKI TSITSIRIGKOU
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Maria-Fereniki Tsitsirigkou is an associate of the firm. She graduated from the Faculty of Law of Democritus University of Thrace in 2013. She is a graduate of City University (LLM in International Maritime Law) and of Sorbonne Panthéon-Assas & INSEAD Business School (LLM in International Business Law in cooperation with INSEAD).

Her professional experience (as a former member of an international solicitors’ firm) focuses on the field of restructuring, banking law and international corporate and commercial
law, including shipping law. She has previously worked on the borrower’s side as an in-house lawyer of a well-established shipping company, as well as on the lender’s side advising foreign banks and funds in the conclusion of loan transactions.

She is a Greek qualified lawyer and is currently attending intensive preparation courses for her admission to the UK and French Bar Association (QLTS/Barreau Exams). She speaks English and French proficiently and is a beginner in Italian.

**DOGUHAN UYGUN**

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Doguhan Uygun is a senior associate and specialises in commercial litigation, international arbitration, arbitration-related court proceedings and dispute resolution matters as well as conservatory relief measures. Mr Uygun is an active trial lawyer with experience of appearing before civil courts, commercial courts, administrative courts and the Court of Appeal. He has extensively advised and represented international and local clients on complex commercial and contractual disputes, shareholders’ disputes, claims for damages, enforcement of foreign court judgments and arbitral awards, intellectual property disputes, unfair competition lawsuits and bankruptcy proceedings before all degrees of courts. In addition, he has successfully represented the defendants in several criminal, administrative and regulatory investigations. He is also heavily involved in commercial transactions and agreements and takes part in mergers and acquisitions for litigation risk assessment. He is the author of a book titled *Dominance through Shareholding Rights under Group of Companies* and numerous publications on commercial arbitration and litigation.

**FEDRA VALENCIA GARCÍA**

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Fedra Valencia is a partner at Cuatrecasas and a renowned specialist in the legal management of bankruptcy proceedings and legal advice on corporate and financial restructuring transactions. She has participated in several bankruptcy proceedings, including some of the most relevant on a national scale, defending the interests of both debtors and creditors, as well as in debt-refinancing transactions (both in and out of court) and corporate-restructuring agreements, which were beneficial for her clients with respect to their creditors. She is also an expert in administrative liability.

Throughout her professional career, she has advised and represented various debtors in the preparation, presentation and follow-up of bankruptcy proceedings, including many companies in the real estate and industrial sectors, as well as participating in agreement proposals and ad hoc processes arising from the aforementioned proceedings, both ordinary and reintegration.

She has also represented the interests of creditors, providing advice to financial institutions and companies in corporate bankruptcy proceedings for a wide variety of sectors, including the air transport, automobile, construction and energy sectors.

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Pei Ting’s main areas of practice are restructuring and insolvency, commercial litigation and international arbitration. She has advised clients on a wide range of contentious and non-contentious restructuring and insolvency matters. She also has experience in representing clients in complex contentious matters involving contractual claims, property disputes, shareholder disputes, banking claims, trust disputes, directors’ duties, and employment.

Pei Ting graduated from the University College of London in 2015 with an LLB (Hons) degree (First Class).
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